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STANDARD BUSINESS

Banking, Credit and Finance

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INTRODUCTION

A brief consideration of modern conditions will enable the student of business to decide that the more he knows about the methods of banking and financial management, the better equipped he will be to seize the fleeting opportunities of twentieth-century business life.

Every business man has more or less to do with banks and banking. It stands to reason therefore that the business man cannot obtain too much knowledge of banking methods. The greater his business, the more need he has of specialized knowledge on this subject. It is an important part of a liberal education in Business Administration.

Individuals here and there may think that only bankers and young men who aspire to become bankers or financiers may profitably study the theories, history and practice of banking and finance. But, as a matter of fact, earnest and ambitious men of all classes may devote time and attention to these subjects with almost absolute certainty that the knowledge thus acquired will greatly profit them sooner or later. And it may be remarked in passing that the opportunities offered to young men trained in matters of finance were never so great or so numerous as they are at the present day. The general demand for specialized knowledge in business is

fully exemplified by the strong demand for young men fitted by study to enter the employ of the great banks and financial houses that are a notable outgrowth of modern business. It is realized by financiers generally that young men thus partially equipped for their services afford splendid material for the practical training in banking and financial management which can be obtained only by actual experience in the bank, trust company, or other financial institution.

It must never be forgotten that the bases of all success in the business world of today are Character and Knowledge. These may well be linked together side by side, since it takes a man of character to enter upon the conscientious pursuit of knowledge. The young man who possesses this combination—character and knowledge—is the young man bankers and financiers are looking for.

As the groundwork for study of Banking and Finance, some knowledge of economics is desirable, especially that portion of the science which deals with the theory of money, the standards of value, and the relation of commerce and credit. The student should fully realize the importance of the subject of finance, and this can hardly be overestimated; for, as a French writer sagely remarked, "It must be said, and said whatever men may think of it, that the finances touch everything, help everything, conclude everything. They are in the state what blood is in the veins of the human body; if it circulates, it carries along with it motion and life; if it stops, paralysis and death supervene. Good organization, good administration, a good condition of the finances, exert therefore imperiously, every-

where and always, a positive, healthful and vivifying action upon the government of a country and the prosperity of its people."

Realizing the importance of the finances in the public economy, the student will readily understand the utility of banking in all commercial communities. He will learn from this volume how the banker stands between the capitalist and the borrower, as the medium whereby arrangements are made for carrying on and expanding domestic trade and international commerce. He will see why the banker becomes a prominent and esteemed citizen of the community, and how great is the banker's influence, individually and collectively, in keeping business on a safe basis; checking the over-enthusiastic and the purely speculative, but ever promoting enterprise on the part of worthy men.

The various steps attending the organization of a bank are clearly shown; also the duties of directors and officers, the functions, rights and obligations of shareholders, requirements as to meetings, etc. The student will learn how bank accounts are opened; how checks are drawn, indorsed, certified, etc.; and how the deposits are handled by the bank; also the rights and duties of depositors.

The working of the Federal Reserve Bank System inaugurated in recent years, is described at length, with copious extracts from the Act of Congress establishing this system whereby the banking institutions of the United States are largely protected against the former dangers of depressions and panics, and the entire business community is there-

by benefited to an appreciable degree. The Federal farm loan system is also fully described.

The manner in which a bank handles commercial paper and other negotiable instruments is not only an important but an interesting feature of the subject of banking, hence it should and does receive considerable attention.

One of the most responsible duties of a banker is the making of loans. The methods used in banks to judge of the reliability and credit of applicants for loans will well repay study, and all engaged in business should have considerable knowledge on the point. In recent years bank credits have been reduced practically to a science. We shall see how this has been brought about, and incidentally study the whole question of commercial reports in connection with bank credits.

The methods by which a bank makes its collections on commercial and other negotiable paper are discussed. These too have been systematized within the past few years and the student of business can assimilate with advantage all the information given on the subject.

Every student should also have a thorough understanding of the monetary system of his own country. We have fully described the monetary system of the United States, including, first, the coinage of gold and silver, and second, the paper money, and have also given, at the end of the volume, a historical review of the monetary events of the world since 1786, which will be found extremely useful for reference.

As part of the monetary system, bank circulation is treated at length and the principles and methods of

making bank note issues receive particular attention.

The study of banking would be incomplete without some knowledge of the system whereby the work of banks is facilitated by means of clearing houses. The clearing house is remarkable among modern developments of business as an institution for the exchange and settlement of checks drawn on a variety of banks. It greatly economizes time, money and labor. The methods, membership, authority, and organization of clearing houses are discussed, and the operations of clearing and payment of balances are fully described.

It is astonishing how many men of business, otherwise well informed, lack precise information upon such matters as the nature of bank reserves and government requirements regarding the reserve. Of late years, there has been a tendency on the part of banks to give the public a better understanding of their periodical reports, while the establishment of the central reserve bank system has by its propaganda added to the general information on the subject; but the average business man and all students of business may well read up on this point, since it is an important feature of American banking. No one can be said to understand the methods of banking unless he understands the question of the reserve; hence the matter is discussed at length in these pages.

The question of exchange in its relation to commerce, both domestic and foreign, and to international affairs generally, is of the utmost importance. All matters pertaining to foreign exchange are particularly interesting, and a complete discussion

of the question will be found in the chapters devoted to the subject.

All business men are interested in the subject of investments, hence it is well to study the various kinds of investments offered to capital, and to obtain an idea of the relative value of each. The chapter on this subject is from the pen of an investment expert of international reputation, a Western banker held in universal esteem.

The method followed throughout this work has been to deal chiefly with principles and methods of more or less general application rather than with individual or local methods. This is for the advantage of the great majority of students of business,—for the greatest good of the greatest number, who will be enabled by a knowledge of the general principles and methods of banking and finance to comprehend individual or local variations in method where these may occur.

A knowledge of the history of banks is desirable because it gives a clearer understanding of the essential principles on which modern banking systems are founded. Time spent in studying the historical section of this volume will therefore be well spent, and this section while relegated to an appendix, will be found extremely interesting in its presentation of the subject.

Questions for periodical review of the text, or self-examination on the subjects treated, have been inserted for convenience at the end of each chapter.

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CHAPTER I

Origin and Use of Money

Section 1. The Medium of Exchange.—Money is both a medium of exchange and a measure of value, but its primary economic function is that of a medium of exchange. It also has a subordinate function, as a standard of value, but the fact of fundamental importance is that it furnishes the community with a medium of exchange.

It makes little difference what the substance is that is recognized as money. It may be gold or silver, nickel or copper, furs or wampum, grain or salt —whatever serves as a instrument for the exchange of commodities between man and man is money, no matter how crudely it performs the function.

When we speak of money, we commonly have in mind gold and silver, or the coinage of base metals, such as are employed by civilized nations for their fractional currency; but it is well to remember that the functions of money have been, and are today among primitive peoples, served by a wide variety of other objects and substances. It is not the substance itself, therefore, that we designate as money, but a substance which, by law or custom becomes invested with utility as a means of exchange, and

thereupon also becomes an object of universal desire, because it will procure for us whatever we desire.

§ 2. **An Early View of Money.**—The true origin and function of money were expounded at least as early as the second century, when Paullus, the great Roman, wrote: "The origin of buying and selling is in exchange. Formerly there were no coins, and merchandise was in no way distinguished from money. Every man, according to the necessity of the time and of things, exchanged what was useless to him for what was useful, and it was generally the case that what one had abundance of, another was deficient in. But as it did not always easily happen that when one person had what another desired, that other had also what the first desired, a substance was chosen whose general and durable value obviated the difficulties of exchange by being a common measure. This substance, having received a public stamp, has use and value less as a material than as a quantity, and is no longer called merchandise, but money."

§ 3. **Man Lives by Exchange.**—When the division of labor has been once thoroughly established in a community said, Adam Smith, it is but a very small part of a man's wants which the produce of his own labor can supply. He supplies the far greater part of them by exchanging that surplus part of the produce of his own labor, which is over and above his own consumption, for such parts of the produce of other men's labor as he has occasion for. Every man thus lives by exchanging or becomes in some measure a merchant, and the community itself grows to be what is properly a commercial society.

§ 4. **Effect of Division of Labor.**—But when the division of labor first began to take place, this power of exchanging must frequently have been very much clogged and embarrassed in its operations. One man, we may suppose, has more of a certain commodity than he himself has occasion for, while another has less. The former consequently would be glad to dispose of, and the latter to purchase, a part of this superfluity. But if this latter should happen to have nothing that the former stands in need of, no exchange can be made between them. The butcher has more meat in his shop that he himself can consume, and the dairyman and the baker would each of them be willing to purchase a part of it. But they have nothing to offer in exchange except the different productions of their respective trades, and the butcher is already provided with all the bread and milk which he has immediate occasion for. No exchange can, in this case, be made between them. He cannot be their merchant, nor they his customers; and they are all of them thus mutually less serviceable to one another.

In order to avoid the inconvenience of such situations every prudent man in every period of society, after the first establishment of the division of labor, must naturally have endeavored to manage his affairs in such a manner as to have at all times by him, besides the peculiar produce of his own industry, a certain quantity of some one commodity or other, such as he imagined few people would be likely to refuse in exchange for the produce of their industry.

§ 5. **Early Mediums of Exchange.**—Many different commodities were successively thought of and

employed for this purpose. In the rude ages of society, cattle are said to have been the common instrument of commerce; and, though they must have been a most inconvenient one, yet in olden times we find things were frequently valued according to the number of cattle which had been given in exchange for them. Thus, the armor of Diomede, says Homer, cost only nine oxen, but that of Glaucus cost a hundred oxen. Salt was formerly the common instrument of commerce and exchanges in Abyssinia; a species of shells in some parts of the coast of India; dried cod in Newfoundland; tobacco in Virginia; sugar in some of the West Indies; hides or dressed leather in other countries; and as late as Adam Smith's day there was a village in Scotland where it was not uncommon for a workman to carry nails instead of money to the baker's shop or the alehouse.

§ 6. **Use of Metal as Money.**—"In all countries, however, men seem at last to have been determined by irresistible reasons to give the preference, for this employment, to metals above every other commodity. Metals can not only be kept with as little loss as any other commodity, scarce anything being less perishable than they are; but they can likewise, without any loss, be divided into any number of parts, as by fusion those parts can easily be reunited again; a quality which no other equally durable commodities possess, and which more than any other quality renders them fit to be the instruments of commerce and circulation.

§ 7. **Advantages of Metal.**—"The man who wanted to buy salt, for example, and had nothing but

cattle to give in exchange for it, must have been obliged to buy salt to the value of a whole ox, or a whole sheep, at a time. He could seldom buy less than this, because what he was to give for it could seldom be divided without loss; and if he had a mind to buy more, he must, for the same reasons, have been obliged to buy double or triple the quantity; the value, to wit, of two or three oxen, or of two or three sheep. If, on the contrary, instead of sheep or oxen, he had metals to give in exchange for it, he could easily proportion the quantity of the metal to the precise quantity of the commodity which he had immediate occasion for."

§ 8. **Various Metals Used.**—Different metals have been made use of by different nations for this purpose. Iron was the common instrument of commerce among the ancient Spartans; copper among the ancient Romans; and gold and silver among all rich and commercial nations.

Those metals seem originally to have been made use of for this purpose in rude bars, without any stamp or coinage. Thus we are told by Pliny, upon the authority of Timaeus, an ancient historian, that, till the time of Servius Tullius, the Romans had no coined money, but made use of unstamped bars of copper, to purchase whatever they had occasion for. These rude bars, therefore, performed at this time the function of money.

§ 9. **Use of Crude Metals.**—The use of metals in this crude state was attended with two very considerable inconveniences; first, the trouble of weighing; and, secondly, that of assaying them. In the precious metals, where a small difference in the quantity

makes a great difference in the value, even the business of weighing, with proper exactness, requires at least very accurate weights and scales. The weighing of gold in particular is an operation of some nicety. In the coarser metals, indeed, where a small error would be of little consequence, less accuracy would, no doubt, be necessary. Yet we should find it excessively troublesome, if every time a poor man had occasion either to buy or sell a copper's worth of goods, he was obliged to weigh the copper coin.

The operation of assaying is still more difficult, still more tedious, and, unless a part of the metal is fairly melted in the crucible, with proper dissolvents, any conclusion that can be drawn from it is extremely uncertain.

Before the institution of coined money, however, unless they went through this tedious and difficult operation, people must always have been liable to the grossest frauds and impositions, and instead of a pound weight of pure silver, or pure copper, might receive in exchange for their goods an adulterated composition of the coarsest and cheapest materials, which had, however, in their outward appearance, been made to resemble those metals.

§ 10. **Origin of Coinage.**—To prevent such abuses, to facilitate exchanges, and thereby to encourage all sorts of industry and commerce, it has been found necessary, in all countries that have made any considerable advances toward improvement, to affix a public stamp upon certain quantities of such particular metals as were in those countries commonly made use of to purchase goods. Hence the origin of coined money, and of the public offices called mints;

institutions exactly of the same nature with those of the ancient alnagers (inspectors) and stamp-masters of woolen and linen cloth. All of them are equally meant to establish, by means of a public stamp, the quantity and uniform goodness of those different commodities when brought to market.

§ 11. **The First Stamped Metals.**—The first public stamps of this kind that were affixed to the current metals used as money seem in many cases to have been intended to ascertain, what it was both most difficult and most important to ascertain, the goodness or fineness of the metal, and to have resembled the sterling mark which is at present affixed to plate and bars of silver, or the Spanish mark which is sometimes affixed to ingots of gold, and which being struck only upon one side of the piece, and not covering the whole surface, establishes the fineness, but not the weight of the metal. Abraham weighed to Ephron the four hundred shekels of silver which he had agreed to pay for the field of Machpelah. They were said, however, to be "the current money of the merchant," and yet were received by weight and not by count, in the same manner as ingots of gold and bars of silver are at present.

The revenues of the ancient Saxon kings of England are said to have been paid, not in money but in kind, that is, in victuals and provisions of all sorts. William the Conqueror introduced the custom of paying them in money. This money, however, was, for a long time, received at the exchequer by weight and not by count.

§ 12. **Institution of Coins.**—The inconvenience and difficulty of weighing those metals with exact-

ness gave occasion to the institution of coins, of which the stamp, covering entirely both sides of the piece and sometimes the edges, too, was supposed to certify not only the fineness, but the weight, of the metal. Such coins, therefore, were received by count, as at present, without the trouble of weighing.

The denominations of those coins seem originally to have expressed the weight or quantity of metal contained in them. In the time of Servies Tullius, who first coined money at Rome, the Roman, "as" or "pondo" contained a pound of good copper. It was divided in the same manner as the English troy (from Troyes, France) pound, into twelve ounces, each of which contained a real ounce of good copper.

§ 13. **Pounds, Shillings, and Pence.**—The English pound sterling, in the time of Edward I, contained a pound, Tower weight, of silver of a known fineness. The Tower pound seems to have been something more than the Roman pound, and something less than the troy pound. This last was not introduced into the mint of England till the 18th year of Henry VIII.

The French livre contained in the time of Charlemagne a pound, troy weight, of silver of a known fineness. The fair of Troyes in Champaign was at that time frequented by all the nations of Europe, and the weights and measures of so famous a market were generally known and esteemed.

The Scots money pound contained, from the time of Alexander the First to that of Robert Bruce, a pound of silver of the same weight and fineness

with the English pound sterling. English, French, and Scots pennies also contained all of them originally a real pennyweight of silver, the twentieth part of an ounce, and the two hundred and fortieth part of a pound.

The shilling, too, seems originally to have been the denomination of a weight. "When wheat is at twelve shillings the quarter," says an ancient statute of Henry III, "then wastel bread of a farthing shall weigh eleven shillings and fourpence."

The proportion, however, between the shilling and either the penny on the one hand, or the pound on the other, seems not to have been so constant and uniform as that between the penny and the pound. Among the ancient Saxons a shilling appears at one time to have contained only five pennies, and it is not improbable that it may have been as variable among them as among their neighbors, the ancient Franks.

§ 14. **Values Have Varied.**—From the time of Charlemagne among the French, and from that of William the Conqueror among the English, the proportion between the pound, the shilling, and the penny, seems to have been uniformly the same as at present, though the value of each has been very different. For in every country of the world, says the author of "The Wealth of Nations," the avarice and injustice of princes and sovereign states, abusing the confidence of their subjects, have by degrees diminished the real quantity of metal which had been originally contained in their coins. The Roman "as," in the latter ages of the republic, was reduced to the twenty-fourth part of its original value, and,

instead of weighing a pound, came to weigh only half an ounce. The English pound and penny contain at present about a third only, and the French pound and penny about a sixty-sixth part of their original value.

By means of those operations the princes and sovereign states which performed them were enabled, in appearance, to pay their debts and fulfill their engagements with a smaller quantity of silver than would otherwise have been requisite. It was indeed payment in appearance only; for their creditors were really defrauded of a part of what was due to them. All other debtors in the state were allowed the same privilege, and might pay with the same nominal sum of the new and debased coin whatever they had borrowed in the old. Such operations, therefore, have always proved favorable to the debtor, and ruinous to the creditor, and have sometimes produced a greater and more universal revolution in the fortunes of private persons than could have been occasioned by a very great public calamity.

§ 15. **Universal Instrument of Commerce.**—Money has now become in all civilized nations the universal instrument of commerce, by the intervention of which goods of all kinds are bought and sold, or exchanged for one another.

The rules which men naturally observe in exchanging them either for money or for one another determine what may be called the relative or exchangeable value of goods.

The word "value," it is to be observed, has two different meanings, and sometimes expresses the utility of some particular object, and sometimes the

power of purchasing other goods which the possession of that object conveys. The one may be called "value in use," the other, "value in exchange." The things which have the greatest value in use have frequently little or no value in exchange; and, on the contrary, those which have the greatest value in exchange have frequently little or no value in use. Nothing is more useful than water; but, generally speaking, it will purchase scarcely anything; scarcely anything can be had in exchange for it. A diamond, on the contrary , has scarcely any value in use; but a very great quantity of other goods may frequently be had in exchange for it.

Note.—The development of the monetary system of the United States is treated at length in Chapter XII.

Questions for Review, Chapter I.

1. What is the true function of money and how early in history was it understood?

2. What were the earliest mediums of exchange?

3. What is the reason for the use of metal as money?

4. What was the nature of the first stamped metals?

5. Who first coined money under the Romans?

6. What was the origin of the English pound sterling?

7. Has the proportion between the pound, the shilling, and the penny always been uniform? How about the proportionate value of these coins?

8. What causes have contributed to the diminishment of the real quantity of valuable metal contained in coins?

9. What two different meanings are attached in economics to the word "value"?

10. Show how many things which have the greatest value in use have frequently little or no value in exchange, and vice versa.

11. What effect did the division of labor have upon the early system of barter and exchange?

12. Give an instance of the use of money as a measure of value, besides being a medium of exchange.

13. In what way does money function as a standard of value?

CHAPTER II

Banks and Their Uses

Section 16. Four Branches of Business.—There are four principal branches or functions of the business of modern banking; namely, (1) the exchanging of money; (2) the lending of money; (3) the borrowing of money; (4) the transmitting of money. It is in this order that the various functions seem to have originated in most countries; but almost down to the period of the American Revolution there was little popular understanding of the true function of banks and considerable mystery surrounded the operations of those who were commonly called bankers.

§ 17. "What Is a Banker?"—This indefinite public knowledge, or lack of knowledge, was evidenced as late in history as the year 1746, when a British statesman, speaking in the House of Commons, inquired: "What is it that we call a Banker? There is in this city of London a company or corporation, called Goldsmiths, and most of those called bankers are of that corporation; but so far as I know, there is not a company or corporation in England called Bankers, nor has the business any definition or description either by common law or by statute.

By custom we call a man a banker who has an open shop, with proper counters, servants, and books, for receiving other people's money, in order to keep it safe, and return it upon demand; and when any man has opened such a shop we call him a banker, without inquiring whether any man has given him any money to keep or no; for this is a trade where no apprenticeship is required, it having never yet been supposed that a man who sets up the trade of banking could be sued upon the statute of Queen Elizabeth which enacts, that none shall use any art or mystery then used, but such as have served an apprenticeship in the same." (See Appendix—"History of Banking.")

§ 18. **A Dealer in Money.**—In the present day, the functions of banks are better understood. A broad view of them, from an international standpoint, is as follows:

A banker is a dealer in capital, or more properly a dealer in money. He is an intermediate party between the borrower and the lender. He borrows of one party, and lends to another; and the difference between the terms at which he borrows and those at which he lends, forms the source of his profit. By this means he draws into active operation those small sums of money which were previously unproductive in the hands of private individuals; and at the same time furnishes accommodation to those who have need of additional capital to carry on their commercial transactions.

§ 19. **Private and Public Banks.**—Banks have been broadly divided into private and public banks. A private bank is that in which there is but one

proprietor or a few partners, and these attend personally to its management. A public bank is that in which there are numerous partners or shareholders, and they elect from their own body a certain number, who are intrusted with its management.

The business of banking consists chiefly in receiving deposits of money, upon which interest may or may not be allowed; in making advances of money, principally in the way of discounting notes and bills; and in effecting the transmission of money from one place to another. Banks in metropolitan cities are usually the agents of the banks in smaller communities and charge a commission on their transactions.

§ 20. **Disposable Means of a Bank.**—The disposable means of a bank consist of—First, the capital paid in by the partners, or shareholders. Second, the amount of money deposited by their customers. Third, the amount of notes they are able to keep out in circulation. Fourth, the amount of money in the course of transmission—that is, money they have received, and are to repay, in some distant place, at a future time.

These disposable means are employed—First, in discounting notes and bills. Second, in advances of money in the form of cash credits, loans, or overdrawn accounts. Third, in the purchase of government, or other securities. Fourth, a part is kept in the banker's till, to meet the current demands.

Of these four ways of employing the capital of a bank, three are productive, and one is unproductive. The discounting of notes and bills yields interest; the loans, and the cash credits, and the overdrawn

accounts, yield interest; the government securities yield interest; the money in the till yields no interest.

The expenses of a bank may be classified thus: Rent, taxes, and repairs of the building or premises in which the business is carried on; salaries of the officers; stationers' bills for books, paper, checks, notes, stamps, etc.; incidental expenses, as postage, light, heat, etc.

The profits of a bank are that portion of its total receipts—including discount, interest, dividends and commission—which exceeds the amount of the expenses.

§ 21. Banks as Commercial Institutions.—In commercial language a bank is a repository, or an establishment, for the purpose of receiving the money of individuals; either to keep it in security, or to improve it by trafficking in goods, bullion, or bills of exchange; and, as stated above, it may be either of a public or of a private nature. A public bank is generally regulated by certain laws, enacted by the government of the nation or state, which constitute its charter, limit its capital, and establish the rules by which it is to conduct business. A private bank, on the other hand, is merely a contract among individuals, for carrying on a trade in money, notes and bills; and the responsibility of the proprietor or partner is usually the only security of those who transact business with it.

Banks then are properly commercial institutions which by affording credits, or issuing notes, as the representative of money, enable merchants, with greater facility, to buy and sell commodities, at home

or abroad. The produce of one country is thus exchanged with that of another, by means of a medium to which an ideal value is attached; hence the great utility of banking establishments in all commercial countries.

§ 22. **Classification of Banks.**—Private banking is the oldest form of the banking business and, as is well known, the antiquity of banks is very great. Records exist of banking transactions among the Assyrians and in the Metropolitan Museum in New York there are Babylonian tablets bearing distinct records of transactions in banking that took place in the reign of Nebuchadnezzar.

Public or incorporated banks may be broadly classified as national and state banks. National banks exist by virtue of national laws. State banks are governed by the acts of state legislatures.

State banks may be further divided into banks of discount and deposit, savings banks, and trust companies. It may also be noted that state banks may exist (a) by virtue of special acts or charters, or, (b) by virtue of general laws under which all such banks acquire the same rights and liabilities.

The establishment of state banks under special legislative charter was the original method employed, but the disadvantages of the charter system are obvious. The charters were costly to the promoters, they could be granted only when the legislature was in session, and they opened the door to corruption on the one hand and to the granting of special privileges on the other.

The enactment of general laws to govern the establishment of banking institutions was made necessary by the evils attending the special charter system. Every state now has a general banking law, providing an inexpensive and ready means of obtaining authority to establish a bank under state regulations. Charters, however, are still granted by some state legislatures, and there are a number of state banks still running under old charters.

§ 23. **National Banks.**—National banks of the United States are established under the National Banking Act and are subject to federal regulation. National banks in other countries have certain relations with their respective governments, and a bank of this character has been twice established in the history of the United States. In each case, the national government founded and conducted such a bank with branches. This bank, with its two periods of existence, was known as the Bank of the United States. The idea of it was conceived immediately after the adoption of the Constitution, by Alexander Hamilton, then Secretary of the Treasury, and the act of Congress incorporating the first bank became law on February 25, 1791. The duration of the bank was limited to the 4th of March, 1811.

The second Bank of the United States, located at Philadelphia with branches in the several states, was created by an act of Congress March 3, 1816, and was conducted until 1836, when a renewal of its charter was denied. In consequence of this, reorganization was effected by means of authority of the legislature of the State of Pennsylvania. The bank assigned in 1841, its affairs being finally liquidated in 1856 and

resulting in the payment in full of interest and principal of liabilities to depositors and note holders; the shareholders, however, received nothing on their investment in stock of the bank.

During President Tyler's administration, efforts were made to establish another national bank to be conducted by the United States government, but the president vetoed the bill and no similar bank was ever re-established.

The first bank in the United States was the Bank of North America, elsewhere referred to (see Appendix,) by which exclusive privileges of a monopolistic character were sought, and these were soon proven to be inconsistent with the general character of an American institution. It was opened for business on January 1, 1782.

The National banks in the United States, and many of the state banks, are now operated in connection with the Federal Reserve system. See Chapter IX.

§ 24 **Banks of Discount and Deposit.**—A bank of discount is owned by the shareholders who contribute the capital. It receives commercial and other deposits, usually payable on demand. It discounts commercial paper, makes short loans for commercial purposes, and is managed by a board of directors chosen by the shareholders, who hold annual meetings to receive reports and elect directors.

A very important provision of the National Bank Act is as follows: "No bank shall loan or discount on the security of shares in its own capital stock unless such security or purchase shall be necessary to pre-

vent loss upon a debt previously contracted in good faith."

§ 25. **Savings Banks.**—Savings banks are organized by trustees and operate usually without a capital stock, having no shareholders. The deposits are received chiefly in small sums, and are payable only after notification by the depositors that they wish to withdraw part or all of their money. In the case of small withdrawals, the notification is usually waived, except in periods of financial stringency or depression. Loans of the deposit funds are made for longer periods as a rule than in the case of banks of discount, and are made to investors, for building purposes, etc. The trustees elect some of their number as directors and these directors manage the business. If a trustee resigns or dies, a successor is elected by the other trustees. The depositors have no voice in the election of officers or in the management of the business.

The United States government also operates a savings bank in connection with the Post Office.

§ 26. **Trust Companies.**—Trust companies are a modern development of the banking business. They combine many of the functions of the older banks of discount with the execution of trusts. Deposits are received by them and interest paid. The making of loans forms an important part of the business. The funds are lent in all cases on collateral security, stocks, bonds, etc., and not, as in the case of commercial banks, on the credit of business men and firms.

Trust companies act as administrators and executors of estates, guardians to minors, trustees for beneficiaries of wills, etc. They are often called upon

also to act as trustees of bondholders in large operations, such as the building or reorganizing of railroads.

One of their principal functions is the management of real estate, especially where the ownership is vested in estates of deceased individuals or in corporations. They act as fiduciary agents in business operations of a greatly varied character, and in recent years have largely replaced individual trustees in the management of estates, etc., for the very good reasons that they possess capital, responsibility, experience, disinterestedness and conservatism, and besides have fixed charges of a reasonable character for the services they render. They have proved a valuable addition to the modern machinery of business.

§ 27. **Utility of Banks.**—In a commercial community banks possess a large sphere of usefulness. Their utility has been well described as sixfold: First, they furnish a safe repository for money; second, they encourage thrift by the payment of interest on deposits; third, they render useful service to all engaged in production, transportation and exchange of commodities; fourth, they also render useful service to their customers by furnishing exchange and otherwise arranging for the transmission of money; fifth, the check system affords a useful record of individual expenditures; sixth, by collecting money in a large aggregate, they render it more effective for purposes of trade and enterprise.

But this list does not include all of the particulars in which banks benefit the business community. As

we shall presently see, they afford a convenient and valuable means for the interchange of information affecting credit; they are useful to business men of probity as references; they keep the community supplied with convenient "change;" in many places they afford the only means of safe deposit for valuables; and last, but by no means least, they exert a tremendous moral force in behalf of honesty, truthfulness, industry, perseverance, thrift, prudence and punctuality.

§ 28. **The Safe-keeping of Money.**—In the first place, banks are useful as places of security for the deposit of money. The circumstances which gave rise to the business of banking in England was a desire on the part of the merchants of London to obtain a place where they might lodge their money in security. Everyone who has had the care of large sums of money knows the anxiety which attends their custody. A person in this case must either take care of his money himself, or trust it to his employees. If he takes care of it himself, he will often be put to inconvenience, and will have to deny himself holidays and comforts, of which a man who is possessed of much money would not like to be deprived. If he intrusts it to others, he must depend upon their honesty and their ability. And, although in many important cases an employer is compelled to do this, yet he does not feel the same satisfaction as if the money was actually under his own care. Some instances of neglect or of dishonesty will necessarily occur, and these will occasion suspicion in reference to other parties against whom no suspicion ought to be entertained. Besides, in both these cases,

the money is lodged in insecure premises, and is subject to thieves, to fire, and to other contingencies, against which it is not always easy to guard.

All these evils are obviated by means of banking. The owner of money need neither take the charge of it himself, nor trust to his dependents. He can place it in the hands of his bankers. They are responsible men or institutions and are accountable to him for the amount. If they are robbed, it is no loss to him; they are pledged to restore to him the amount of his deposit when he shall require it. Whenever he wants money he has only to write an order, or check, upon his banker, and the person to whom he is indebted takes the check to the bank, and without any hesitation or delay receives the money.

§ 29. **The Allowance of Interest.**—Bankers often allow interest for money placed in their hands on deposit. This is a direct incentive to thrift, especially in the case of depositors in savings banks.

By means of banking, the various small sums of money which would have remained unproductive in the hands of individuals, are collected into large amounts in the hands of the bankers, who employ it in granting facilities to trade and commerce. Thus banking increases the productive capital of the nation. At the origin of banking, "the new-fashioned banker," as they were called, allowed a certain rate of interest for money placed in their hands. The banks of Scotland carry this practice to the greatest extent, as they receive upon interest so low an amount as ten pounds, and also allow interest on the balance of a running account. Many of the country bankers in England allow interest on the

balance of a running account, and charge commission on the amount of the money withdrawn. The London bankers generally do not allow interest on deposits, but neither do they charge commission. All their profits are derived from the use of their customer's money. The banks of Scotland do not charge commission, although they allow interest on deposits; but those banks have a profit by the issue of their notes. The London bankers do not issue notes. The practice of paying interest on general deposits is becoming more common in America.

§ 30. **The Loaning of Money.**—Another benefit derived from bankers is, that they make advances to persons who want to borrow money. These advances are made (a) by discounting bills or notes; (b) upon personal security; (c) upon the joint security of the borrower and two or three of his friends,—and sometimes (d) upon mortgage. Persons engaged in trade and commerce are thus enabled to augment their capital, and consequently their wealth. The increase of money in circulation stimulates production.

When bankers are compelled to withhold their usual accommodation, both the commercial and the agricultural interests may be plunged into extreme distress.

The great advantage arising to a neighborhood from the establishment of a bank, is derived mainly from the additional supplies of money advanced in the form of loans, or discounts, to the inhabitants of the place.

§ 31. **The Transmission of Money.**—Another benefit derived from bankers is, that they transmit money from one part of the country to another.

There is scarcely a person in business who has not occasion sometimes to send money to a distant town. But how is this to be done? He cannot send a messenger with it on purpose—that would be too expensive. He cannot send it by mail—that would be too hazardous. How, then, is the money to be sent? He can either mail a check on his own bank, which can be cashed or deposited for credit in the distant town or he can "buy exchange" on New York or Chicago and mail the bank draft. In either case the banks concerned effect the transfer of the required funds, without risk to the person accommodated.

§ 32. **Exchange of Currency.**—Wherever a bank is established, the public is able to obtain that denomination of currency which is best adapted for carrying on the commercial operations of the place. In a town which has no bank, a person may have occasion to use small notes, and have none but large notes, and at other times he may have need of large notes, and not be able to obtain them. But where a bank is established there can be no difficulty of this kind. The banks issue that description of notes which the receivers may require, and are always ready to exchange them for others of a different denomination.

Banks, too, usually supply their customers and the neighborhood with gold and silver coinage as required; and if, on the other hand, silver or gold should be too abundant, the banks will receive it, either as a deposit, or in exchange for their notes.

Hence, where banks are established, it is easy to obtain change. This is very convenient to those who have to pay large sums in wages, or who purchase in small amounts the commodities in which they trade.

§ 33. **An Economy of Time.**—By means of banking there is a great saving of time in making money transactions. It takes much longer time to count out a sum of money, especially in various European currencies, than it does to write a check. And it is much less trouble to receive a check in payment of a debt and then to pay it into the bank, than it is to receive and handle a sum of money in currency. What inconveniences would arise from the necessity of weighing gold coins in some countries! What a loss of time from disputes as to the goodness or badness of particular pieces of money!

Besides the loss of time that must necessarily occur on every transaction, we must also reckon the loss which every merchant or tradesman, in an extensive line of business, might and in many countries would certainly sustain in the course of a year from receiving counterfeit or deficient coin or it may be, spurious notes. From all this risk he is exempt by having a banker. If he receives payment of a debt, it is in the form of a check upon his customer's banker. He pays it into his own bank, and no coin or bank notes pass through his hands. If he makes drafts, those drafts are presented by his banker: and if his banker takes bad money, it is his own loss.

§ 34. **Collection of Drafts.**—A business man who has a banker saves the trouble and expense of pre-

senting those bills or drafts which he may draw upon his customers, or which he may receive in exchange for his goods. He pays these into the hands of his banker, and has no further trouble. He has no care about the custody of his bills receivable—no anxiety about being stolen—no danger of forgetting them until they are overdue, and thus exonerating the indorsers—no trouble of sending to a distance in order to demand payment. He has nothing more to do than to see the amount entered to his credit in his banker's books. If a draft or note be not paid, it is brought back to him on the day after it falls due, properly noted. The banker's clerk and the notary's clerk are witnesses ready to come forward to prove that it has been duly presented, and the notary's ticket attached to it assigns the reason why it is not paid. This circumstance alone may cause an immense saving of expense to a mercantile house in the course of a year.

Doing business through a banker also prevents loss from various kinds of mistakes that may be made by the employees of a business house. In a banking-house mistakes are not so likely to occur, though they do occur, sometimes; but the loss falls upon the banker, and not upon his customer.

§ 35. **The Banker as a Reference.**—Still another advantage of having a banker is, that by this means the business man has a continual reference as to his respectability. If the banker is applied to through the proper channel, he gives his testimony as to the respectability of the customer. This may be an immense advantage to a man in business, as a means

of increasing his credit; and credit, as Benjamin Franklin said, is money.

The keeping of an account with a bank enables a merchant not only to give a constant reference as to his own respectability, but it also enables him to ascertain the respectability of other persons who deal with bankers. There are numerous cases in which a merchant may wish to know this, especially where such facilities as the commercial agency reports, with which every American business man is familiar, are lacking.

Among nearly all bankers, says Gilbart, "the practice is established of giving information to each other as to the respectability of their customers. For as the bankers themselves are the greatest discounters of bills, it is their interest to follow this practice; and indeed the interest of their customers also, of those at least who are respectable."

§ 36. **A Record of Expenditures.**—By means of banking, people are able to preserve an authentic record of their annual expenditure. If a person pays in to his banker all the money he receives in the course of a year, and makes all his payments by checks—then by looking over his bank account and check-book at the end of the year he will readily see the total amount of his receipts, and the various items of his expenditure.

"This is very useful to those who have not acquired habits of business, and who may therefore be in danger of living beyond their means. It is useless to advise such persons to keep an account of their expenses—they will do no such thing; but

when short of money at Christmas to pay their bills, they may take the trouble of looking over their check-book, and noticing how many checks were drawn for the purchase of unnecessary articles."

A bank account is useful also in case of disputed payments. People do not always take receipts for money they pay, and when they do the receipts may be lost or mislaid. In case of death, or of omission to enter the amount in the creditor's books, the money may be demanded again. Should the payment have been made in currency, the payer can offer no legal proof of having settled the account; but if the account was discharged by a check on a banker, the check itself can be produced, and the payment proved by the officers of the bank, who can be subpoenaed for that purpose.

§ 37. **Safe Deposit for Valuables.**—Another advantage resulting from a banker in many places that lack safe deposit vaults is, the customer has a secure place of deposit for any deeds, papers, or other property that may require peculiar care. If a person were going to the country he might send his plate or jewelry to his banker, who will lock it up in his vault and thus it will be preserved from fire and thieves until his return. European lawyers, stockbrokers, and others, who have deeds, securities or other documents of importance left in their custody, can send them to the bank for the night, and thus avoid the danger of fire. In America, safety deposit vaults are now found in every city of importance, often operated in connection with banks. In the smaller cities, towns and villages, the banker is a universal custodian of valuables for his depositors.

§ 38. **Valuable Help in Business.**—By having a banker, people have a ready channel of obtaining much information that will be useful to them in the way of their business. They will learn the way in which bankers keep their accounts; and may learn many of the laws and customs relating to negotiable paper. If they have to buy or sell bonds, stocks, or shares the banker can send them to a respectable broker, who can manage the business; or should they be about to travel, and wish to know the best way of receiving money abroad; or be appointed executors to a will, and have to settle money matters—the banker will in these and many other cases, be able to give them the necessary information.

§ 39. **A Moral Influence for Good.**—Banking also exercises a powerful influence upon the morals of society. It tends to produce honesty and punctuality in pecuniary engagements. Bankers, for their own interest, always have a regard to the moral character of the party with whom they deal: they inquire whether he be honest or tricky, industrious or idle, prudent or speculative, thrifty or extravagant, and they will more readily make advances to a man of moderate property and good morals than to a man of large property but of inferior reputation.

Thus the establishment of a bank in any place immediately advances the pecuniary value of a good moral character. There are numerous instances of persons having risen from obscurity to wealth only by means of their moral character, and the confidence which that character produced in the mind of their banker. It is not merely by way of loan or discount

that a banker serves such a person. He also speaks well of him to those persons who may make inquiries respecting him and the banker's good opinion will be the means of procuring him a higher degree of credit with the parties with whom he trades.

These effects are easily perceivable in country towns; and even in great cities, if a house be known to have engaged in speculative transactions, or in any other way to have acted questionably, their paper will be taken by the bankers less rapidly than that of a strictly reputable house of smaller size.

It is thus that bankers perform the functions of public conservators of the commercial virtues. From motives of private interest they encourage the industrious, the prudent, the punctual, and the honest —while they discountenance the spendthrift and the gambler, the liar and the knave. They hold out inducements to uprightness, which are not disregarded by even the most abandoned. There is many a man, says Gilbart truly, who would be deterred from dishonesty by the frown of a banker, though he might care but little for the admonitions of a bishop.

Questions for Review, Chapter II.

1. What are the four principal functions of a modern bank?
2. Into what classes are banks divided?
3. What are the principal features of the business of banking?
4. What funds constitute the disposable means of a bank?
5. How are these disposable means employed?

6. How may the expenses of a bank be classified?
7. How are the profits of a bank reckoned?
8. Give a definition of a bank in commercial language.
9. How is a public bank generally regulated?
10. What is the nature of a private bank?
11. What is the security of those who transact business with a private bank?
12. What features constitute the great utility of banking establishments in commercial countries?
13. What was the first consideration that gave rise to the business of banking?
14. What evils are obviated by means of banking?
15. In what way does banking increase the productive capital of a nation?
16. What advantages are secured to persons engaged in trade and commerce, by means of banking?
17. How does the institution of banking facilitate the transmission of money?
18. In what way does banking save the time and expense of a merchant or retail tradesman?
19. How do banks aid business men by acting as references for them?
20. Show how the system of paying by means of checks enables one to preserve a record of expenditures.
21. What effect has banking upon the morals of society?
22. How do banks aid business by the dissemination of useful information?

CHAPTER III

Methods of Banking

Section 40. Facilities for Commerce.—Banks are absolutely necessary to the success of modern commercial enterprises. They provide a place for the safe-keeping of money and securities, as we have seen, and make the payment of bills much more convenient than if currency instead of checks were the more largely used. But the great advantage of a banking institution to a business man is the opportunity it affords him of borrowing money, of securing the cash for the carrying on of his business, while his own capital is locked up in merchandise or in the hands of his debtors. Another and important advantage is to be found in the facilities afforded by banks for the collection of checks, notes, and drafts.

The legal medium of exchange of a country is called its currency, that which passes current, or circulates as money, such as coin and bills. Bullion is uncoined gold or silver. More than ninety per cent of the cash circulation of the country is represented by checks, etc., and not by actual money. It is the banks of the country that make the convenient check system possible.

§ 41. Organization of Banks.—The national banks are organized under national laws while state

banks, savings banks, etc., are organized under the laws of the State in which they are located.

Any person who has money and credit can start a private bank. Some of the largest banking institutions of the world are owned by private individuals, and are not subject to law any more than is any other kind of business concern.

By an act of Congress of 1864 the corporate life of a national banking association was fixed at twenty years. Under date of July 12, 1882, an act was passed authorizing extensions for an additional period of twenty years and second extensions were authorized by an Act of April 12, 1902.

§ 42. **National Banks.**—Section 5133 of the Revised Statutes, formerly Section 5 of the act of June 3, 1864, provides for the organization of national banking associations by any number of natural persons not less than five. The law confers authority upon the Comptroller of the Currency to approve the corporate title of an association and also to withhold his certificate authorizing an association to begin business when, as the result of special examination or otherwise, it is ascertained that the association has been organized for purposes other than those contemplated by the act. It is further provided that no banks shall be organized with capital less than $100,000 unless sanctioned by the Secretary of the Treasury. This was reduced to $25,000 in certain cases, in 1900.

To avoid formation of associations for ulterior purposes or by those lacking the qualifications necessary to successful conduct of the banking business,

or in a place the population and business of which are insufficient to warrant the establishment of a national bank, the Comptroller, upon receipt of an application to organize, causes a special investigation to be made, the results of which determine the favorable or unfavorable action.

The expansion of the national banking system along normal, safe, and conservative lines is unquestionably desirable, but the Comptroller of the Currency takes the view that the organization of a bank is not warranted in a community where there is no reason for its existence; that is, where sufficient business would not naturally come to warrant success, or where the board of directors will not be composed of men of business ability equal to the best to be found in the community, or where the organization is attempted by promoters who, by public and private means, create a false impression that a bank is needed and that success is assured by merely obtaining subscriptions to the capital stock. Comparatively few applications for authority to organize national banks are rejected, however.

See chapter IX on the operation of the Federal Reserve System.

The number of national banks reporting to the Comptroller of the Currency in 1919 was 7,762, with a total capital of $1,115,507,000 and total surplus of $869,457,000. The net earnings of these banks in that year were $299,980,000.

§ 43. **State Banks.**—National banks are the only banks of issue in the United States. But the States have chartered several forms of deposit banks in

large numbers while private bankers are also numerous.

The business operations of State banks differ from those of national banking associations only in so far as they lack the feature of note issue. It is an advantage to State banks and trust companies to become members of the Federal Reserve system, which was organized to meet the need of commerce in peace, and proved equal to the enormous burden forced upon it by the World War. Through membership in this nation-wide system a State bank or trust company safeguards the interests of its depositors and stockholders more fully than when operating as a non-member bank, not only as to the repayment of deposits, but also as to its ability to supply legitimate demands for loans.

The total number of State banks and trust companies in the United States approximates 22,000. The combined resources of all the 29,135 banks (including national, state, and federal reserve banks) reporting in 1919 aggregated over fifty-two billions of dollars.

§ 44. **The Name "Bank."**—In some of the states the title Bank can be lawfully used by anyone; in other states, for instance, New York and Massachusetts, the title Bank can be used only by duly incorporated banks which are organized and conducted under the provisions and restrictions of the national or state banking laws.

§ 45. **Officers of a Bank.**—Banking associations are organized for business, generally speaking, very much like any other incorporation. The stockholders

elect a board of directors and the latter appoint the officers.

The directors of a bank meet regularly to consider the character of the paper offered for discount, and to consult regarding the general business of the bank. Sometimes the directors give the president or cashier authority to pass upon paper offered for discount.

The ordinary officers of a bank are the President, who is the chief executive officer; the Cashier, who is the manager of the internal workings of the bank; the Paying Teller, who pays out all moneys and has charge of the working cash of the bank; he is familiar with the signature of each depositor and with his daily balance, and is really one of the most important officers of the bank. He should be a man of good ability and accurate judgment, and withal, possessed of patience and unwavering good nature. The Receiving Teller receives all moneys coming into the bank, and makes the entries in the depositors' pass-books. The Note Clerk has charge of the commercial paper handled. The Bookkeeper and his assistants have charge of the ledgers and other account books.

§ 46. **Bank Loans.**—A portion of the loans of many banks consists of investments in solid bonds, but the bulk of the loans of banks are made on commercial paper; time and demand loans are made upon collaterals of many descriptions. The larger banks loan, on an average, from fifty to one hundred thousand dollars a day. A very large proportion of the commercial paper discounted is first handled by note brokers.

Banks discount paper for their depositors—and simply term the operation discounting; but when they go outside of their line of depositors, in making investments in time paper, they call it buying paper. They generally buy from private bankers and note brokers.

National banks are prohibited from loaning over ten per cent of their capital and surplus to any one individual or corporation, except upon paper representing actually existing merchandise.

§ 47. **Use of Instruments of Credit.**—All the wholesale transactions of business and a large part of the retail transactions are completed by the passing of instruments of credit or negotiable paper, as notes, drafts, checks, etc.; a part of the retail trade only is conducted by what is called cash, that is, bills and small change. It is the function of banks to deal with these transferable instruments legally called "titles."

Banks deal to a very small extent in actual money. The notes, drafts, bills of exchange and bank deposits are representative of the property passing by title in money from the producers to the consumers. A small proportion, perhaps six or eight per cent, of these transactions is conducted by the use of actual bank or legal tender notes.

This trade in instruments of credit amounts to something like fifty billions of dollars yearly. The losses through mercantile failures rarely exceed one hundred millions a year, that is one dollar in every five hundred, or one-fifth of one per cent of the gross amount of business.

§ 48. **Borrowing from Banks.**—It is the business of a bank to loan money to responsible persons, within reasonable limits. The regular customer of the bank is entitled to and will receive the first consideration if the demand is larger than the bank can safely meet.

A business man should not hesitate, when occasion requires, to offer his bank any paper he may want discounted, if in his opinion it is good, nor should he be offended if his banker refuses to take it, even without giving reasons.

Make your own notes and acceptances payable at your bank. Keep a careful record of the dates of maturity of all paper which you make or indorse. It is usually better, that is, more convenient to the holder, to pay your note early on the day it falls due, rather than a day or two before.

§ 49. **Rates for Loans.**—In loaning money on demand, when it is strictly understood between bank and borrower that the money so advanced is positively minute money—money returnable at any minute, when the bank calls for it—banks usually charge low rates of interest. When interest rates are high, bankers prefer to deal in long-time paper. This general rule is reversed when the situation is reversed.

Bankers aim also to scatter and locate their maturities so that as the seasons roll around, they will not have very large amounts maturing at one time and very small amounts at another. They plan also to be "in funds" at those seasons when there is always a large and profitable demand for money.

For instance in the centers of the cotton manufacturing interest the banks count on a large demand for money between October and January when the bulk of the purchases to supply the mills are made: again, among those who operate and deal in wool there is an active demand for money in the wool clip in the spring months. The wheat and corn crops are autumn consumers of money. Midwinter and midsummer in the north are usually periods of comparative stagnation in the money market.

All these things affect rates, and the successful banker is he who from observation and large experience shows the most skill in timing his money supply.

§ 50. **When Interest Accrues.**—There are certain well-defined principles which make clear when interest is accruing and when it is not. Money voluntarily left by any one in the hands of another will not, of course, draw interest unless a specific mutual agreement to that effect is made. In most cases, a demand note bears interest even though there be no statement to this effect on the face of the note.

Money on deposit in a bank without an agreement to pay interest will not accumulate interest even though it remain fifty years.

§ 51. **Forged Indorsements.**—A bank is supposed to know the signatures of its depositors. It is one of its first and most important duties to have them on file and immediately accessible by the use of a well-kept signature book or card system.

Holders of checks, in very many cases, know nothing about these drawer-signatures. They have

taken them supposing, of course, that they are genuine. When they have collected the checks at the bank upon which they are drawn they are to a very great extent relieved of all further responsibility as to the signatures of the signers, for the bank by paying them has guaranteed their genuineness.

But the bank which cashes for a good holder a much indorsed check, the signature of which is all right, generally knows nothing about its many indorsements beyond the fact that they seem to be all right and stand there in regular order, apparently correctly made. For the honesty and genuineness of these many or few preceding indorsements the last holder, for whom the check is cashed, whether he indorse the check or not, is fully and legally held, and no reasonable lapse of time before a discovery of the forgery is made will relieve him of this liability.

§ 52. **The Credit Department.**—One of the most valuable parts of a banker's education is to learn whom to trust. Every bank should have a well-organized and thoroughly equipped credit department, in charge of some one who can be relied upon to investigate carefully all names referred to him by the officers.

A man who desires to borrow money from a bank should offer the same confidence that he would offer if he were going to a wholesale dealer to buy goods. The merchant has a commodity to sell and he looks for facts which will aid him in determining the line of credit to be granted. The banker has money to sell and he should be doubly sure of the responsibility of the party to whom he is selling it because the

money does not belong to him. A banker has a right to expect the fullest confidence on the part of the borrower, and the borrower should furnish him with a complete and detailed statement of the condition of his affairs. It is safe to conclude that when a borrower refuses absolutely to give any information as to his financial condition, his credit is not in the most favorable condition.

§ 53. **Statements for Credit.**—Many of the banks have blank forms which they from time to time ask borrowers to fill out. These statements show in detail the assets and liabilities of the individual firm, or company in question; they show the notes which are outstanding, the mortgages on real estate, and many other particulars including the personal or individual credit of members of the firm, if a partnership. The total net worth of the borrower should be first considered; then the character of his business, whether it is speculative or staple; then his record and standing in the community; then his business habits; then a consideration of whether he is in enterprise abreast with modern ideas and methods.

§ 54. **Paper Offered for Discount.**—The paper offered for discount is of a variety of kinds. The larger proportion of it is from customers of the borrower who have extended their credit by paying their accounts in notes instead of in cash. Such paper is really, though having two names, very little better than single-name paper, for it is not the maker's credit, but the payee's, which the bank usually considers. Many very small notes offered for discount usually indicate a very needy condition.

There are times when the character of the mer-

chandise owned by the borrower should be considered. What would it bring under the hammer? Groceries and raw materials can usually be turned into cash at a forced sale at very small discount from current prices. Not so with hardware, glass, dry goods, boots and shoes, books, etc. Machinery and fixtures are not a bankable asset upon which to base credit.

The banker should also note his borrower's bills payable. Why did he give notes? Are they met promptly? Many houses prefer to sell their own paper in the open market and keep their banks open for accommodations when they are unable to secure outside credit.

The insurance carried should be considered, also the volume of business done. A large business on moderate capital, with long credits, will naturally have large liabilities, while a small business, with liberal capital, and short credits, should have small liabilities.

There are many firms which carry two or more bank accounts and others who sell their paper to out-of-town banks. In buying paper it is important to ascertain whether the firm is in the habit of taking up paper at one bank by floating a note at another.

§ 55. **Classification of Paper.**—A prominent banker classifies paper as to its discount value as follows:

(a) Bankers' paper, including bills of exchange.

(b) Remittance paper—bills drawn by houses abroad on banks or correspondents in Europe.

(c) Inland drawn paper—bills drawn by shippers of goods on the houses to whom the goods are shipped.

(d) Broker's Paper.—Bills drawn by importers against commodities placed in brokers' hands for sale.

(e) Trade paper—bills arising out of our manifold trades and industries.

(f) Drafts with bills of lading attached.

(g) Paper having personal indorsements.

(h) Paper secured by collateral.

(i) Individual—or one name paper.

§ 56. **Usury and Its Penalty.**—The laws of some of the states for collecting more than the legal rate of interest are quite severe. National banks which collect more than the legal rate can only be proceeded against under the U. S. Interest Penalty Act, which provides that usury shall be punished by a forfeiture of twice the amount of interest paid, if action is commenced within two years of the time of such usurious practice, and that recovery can be had for the entire amount of interest paid at any time.

§ 57. **Bank Examinations.**—National banks are examined once or twice a year by a United States bank examiner, who has authority from the Comptroller of the Currency, to whom his reports are made. These reports are seldom if ever seen by bank officers, and unless the examiner chooses to inform them that everything is right they are none the wiser.

When a national bank becomes embarrassed it is the business of the bank examiner to look thoroughly into its affairs and if necessary to close its doors.

§ 58. **Bank Statements.**—A bank statement is a balance-sheet of the bank's main ledger, and is sworn to by the cashier and attested by several of the directors. It is published at the time of its making in the local newspaper.

The resources in such a statement usually consist of items due from other financial institutions, bank bills, and specie on hand, bonds deposited with the United States treasurer; loans and discounts, consisting of discounted notes, drafts, etc., owned and held by the bank and which are maturing and being paid from day to day; real estate, etc.

The liabilities consist of the accounts due depositors and other banks; outstanding circulation of bank notes; undivided profits; surplus fund; original capital stock, etc.

§ 59. **Bank Debits and Credits.**—The bank's debits for any day may consist of the following items:

(a) Deposits—the gross amount of money received on deposit.

(b) Matured loans—notes discounted that have been paid.

(c) Interest—money received for interest from all sources.

(d) Exchange—money received as exchange on collections.

(e) Discount—the discounts on notes and other commercial paper.

(f) U. S. Treasury—remittances received in payment for notes sent for redemption.

(g) Circulation—new bank notes of the bank's own issue received from Comptroller of the Currency.

The bank's credits may consist of the following:

(a) Checks—paid during the day.

(b) Loans—gross amount of net proceeds of paper discounted.

(c) Expense—running expenses of the bank.

(d) Interest—on deposits and rebates on prepaid discount paper.

(e) Exchange—cost of collections made, charges on foreign paper, etc.

(f) Dividends—paid stockholders.

(g) U. S. Treasury—cash sent for new small legal tenders, etc.

(h) Circulation—notes of the bank's own issue retired in any way.

§ 60. **Accurate Interest.**—The Treasury Department at Washington pays accurate interest, founded on a basis of 365 days to the year. The great majority of banks pay and charge interest on a basis of 360 days to the year.

§ 61. **Money "On Call."**—National banks located in clearing-house centers, find it a very convenient thing to put out quite a percentage of their loans on call. In some cities banks have a habit of borrowing

on call from each other on clearing-house settlements. Call notes are payable on demand and are secured by demand notes.

§ 62. **Collaterals.**—If a business man borrow $1,000 from a bank on his note and give ten shares of stock to the bank to be held by it simply as security, the stock thus given would be termed collateral. These collaterals are not the bank's property, and the bank is responsible for their safe-keeping. If coupons mature while bonds are being held as collateral, the owners are usually allowed to collect the amount for which they sell. Sometimes one note is given as collateral security for another which is discounted.

§ 63. **The Bank's Cash.**—The actual usable cash of a bank is represented by the gold, silver, and bills on deposit.

It is estimated that the gold in use in the world amounts to $9,000,000,000, and that an equal amount has been lost through wear and other causes since the earliest times. A million dollars in gold could be put into a box two feet square and a foot deep. All the gold in the world could be put into a room 64 feet by 50 feet with a height of 20 feet.

The gold in our banks lies piled in bags containing $5,000 each. Each bag weighs twenty-two pounds. Standard gold is worth $18.96 an ounce, and a $20 gold piece weighs 21½ pennyweights. In shipping gold from New York to London it is estimated that a million dollars in gold may be reduced in value, by the coins rubbing against each other, about $175.

If a standard gold coin falls short one-half of one

per cent of its original standard weight, it is marked "light weight" the moment it reaches the United States Treasurer. It then ceases to travel as money.

The United States bills which are considered cash are of a variety of kinds, including notes of the following denominations: $1, $2, $5, $10, $50, $100, $500, $1,000. These are payable in coin, either gold or silver.

The total amount of money in circulation in the United States on July 1, 1920, was $6,084,854,578 including the following: Gold Coin, $834,687,970; gold certificates, $390,522,834; standard silver dollars $133,978,687; silver certificates, $118,521,774; subsidiary silver, $251,104,384; Treasury notes of 1890, $1,656,355; United States notes, $337,299,793; Federal reserve notes $3,122,001,747; Federal reserve bank notes, $198,735,191; national bank notes, $696,345,834.

§ 64. **Paper Currency.**—The national bank notes are really promissory notes, issued by the banks, and payable on demand. They are secured by, and issued upon, the deposit of United States bonds or certificates of indebtedness. Every national bank must redeem its notes in full in lawful money at the Treasury in Washington or over its own counter whenever a demand for payment is made. The denominations of the national bank notes are the same as those of the United States notes.

The gold and silver certificates are notes issued by the United States government and payable on demand in gold and silver dollars respectively.

§ 65. **Mutilater Currency.**—Notwithstanding the

fact that the paper used is of the very best quality, paper money, the world over, is constantly becoming ragged and mutilated, and it may be well to quote here the law which regulates the redemption of mutilated bills. If the whole face of a note is in a condition which will permit its being recognized as a genuine bill it will be paid in full. If not more than two fifths of the paper of a national bank note is gone and the note shows the name of the bank and the signature of one of its officers, it will be paid in full.

"United States notes, Treasury notes of 1890, fractional-currency notes, gold certificates, silver certificates, and national bank notes, when mutilated so that less than three-fifths, but clearly more than two-fifths, of the original proportions remains, are redeemable by the Treasurer only, at one-half the face value of the whole note or certificate. Fragments not clearly more than two-fifths are not redeemed, unless accompanied by a satisfactory affidavit.

"Fragments less than three-fifths are redeemed at the face value of the whole note when accompanied by an affidavit of the owner or other person having knowledge of the facts that the missing portions have been totally destroyed."

§ 66. Counterfeit Notes.—All United States notes are printed in sheets of four notes of one denomination on each sheet. Each note is lettered and numbered twice. All notes of which the number when divided by 4, shows remainder of 1, have the check letter A; a remainder of 2, the check letter B; a remainder of 3, the check letter C; those numbers which divided by 4 show no remainder, have the check letter D. Any United States note the number of which cannot be divided by 4 and show one of the foregoing results is a counterfeit.

There are no secrets in the art of detecting counter-

feits. Careful study, long experience, and a thorough familiarity with all kinds of genuine bills, will make any person an expert. Banks are required by law to stamp as "Counterfeit" all bad bills coming into their possession.

§ 67. **A Depositor's Credit.**—As a rule, banks do not make known even to a single individual the extent of a customer's business or the size of his bank account. However, any shareholder in a bank has a right, as one of the proprietors, to examine the books, so long as such examination is not an unreasonable interference with the regular routine of work; and it is pretty generally known that a large depositor can either directly or through some other bank get at the condition of a small depositor's account.

§ 68. **Giving Bonds for Faithful Service.**—Bank clerks and officers are usually required to give bonds, that is, they must get some person to go their surety, thus guaranteeing faithful service, and agreeing to make good any losses caused by defalcation or carelessness. There are now several surety companies that give bonds for everyone and anyone whom they consider a "good risk," upon the payment of certain premiums as in insurance.

If a young man is an applicant, say, for a position in a bank and the bank requires that some one give a bond, that is, go his surety, for $10,000, and the young man has no rich father or other relative to guarantee the house against loss, he applies to a bond insurance company and if his record and habits are good he has no difficulty in securing the necessary papers.

The amount of the bond required depends upon the importance of the position applied for. Presidents of banks do not usually give bonds.

The bonds of personal friends have always a good deal of moral weight and force and for this reason are considered superior to the bonds granted by a guarantee company. Such a bond is really a testimonial, and the last one that is likely to be violated. The record shows that marvelously few employees have violated such bonds.

The guarantee companies look into a man's standing very thoroughly before taking the risk of becoming his surety. When an application is made, references are given and the company corresponds with the persons whose names are given as references and asks a great many very important questions. A young man with good social standing can usually secure bonds for five or ten thousand dollars by the payment of a small annual premium.

§ 69. **Mercantile Agencies.**—In large cities and towns, bankers and other business men often avail themselves of the advantages offered by mercantile agencies. These concerns report to their subscribers upon the credit of men in various lines of business. They gather their information from a variety of sources. This service has been very much improved of late years, and after making all due allowance for the inherent defects of the system, it is still a useful adjunct to the man who is giving credit.

§ 70 **Savings Banks.**—Savings banks have no special capital owned by the stockholders. Their capital is the money received on deposit, which, of course, is the property of a great many people. Every de-

positors is an owner in the bank, and the profit is paid to depositors in interest. This capital is invested in choice securities. The corporation is simply the agent or trustee of the whole body of depositors, and works for their account and benefit and not for its own.

In most of the States, the savings banks are organized under State laws and are in a limited way under State supervision. Their chief purpose is to encourage the saving of money by the common people.

The Postal Saving bank system of the United States, though of recent establishment, received deposits in the fiscal year ending June 30, 1919, amounting to $136,838,361.

§ 71. **Defalcations and Embezzlements.**—An experienced banker offers the following suggestions to prevent defalcations and embezzlements through the manipulating of the bank's record books: Secure clerks of high character and integrity and have a proper system of accounts with a perfect system of checking everything. If possible keep accounts in duplicate. The balance ledger can be proved to a cent every day, and this should certainly be done. When practicable, it is better to have all differences investigated, and reported upon by some one who is not directly responsible.

A number of banks in the large cities have created the position of auditor of accounts, and it is one of his duties to report to the cashier direct upon all differences. This auditor reconciles accounts-current with out-of-town correspondents, balances and delivers all passbooks, and furnishes information to

all depositors respecting their accounts. A great benefit is secured to a bank by the examination of one man's work by another.

Passbooks of active accounts should be written up once a month, and no passbook should run longer than two months before being balanced. It should be a rule in every bank that no charge entry should be put through the books, except from a proper voucher, that is, a check signed by a depositor, or a charge ticket made out and signed by an officer of the bank. The discount clerk and the collection clerk should not be the same person and neither of them should be the corresponding clerk. The monthly accounts-current rendered by a city correspondent should be reported upon promptly, and any disposition on the part of the bookkeeper to delay or neglect this matter should be corrected.

A very important requisite in modern banking is a system of thorough examination at irregular intervals. No teller, bookkeeper, or other clerk can suffer the slightest harm from having his cash and books examined and found correct. All notes held for collection should be accounted for, and balances due from other banks for collections should be verified. Special deposits of securities held for safekeeping should be examined occasionally. The more complex the bookkeeping the easier it is to "cook" the accounts.

§ 72. **Commercial Crises.**—Disturbances of the course of trade arise largely from the necessity of readjusting its conditions to the common standard and measure of value. The common standard of value is money, and the conditions of trade which

require to be adjusted to it are the price of commodities, and contracts and obligations of all kinds. Contracts and obligations, agreements to pay money at a future time for something presently received, form the credit system of modern commerce. Inability to meet these obligations constitutes bankruptcy, and a great multiplicity of bankruptcies occurring simultaneously constitutes a commercial crisis.

If all persons were in the habit of paying immediately for everything received, there could be no debts, and consequently no failures nor panics. Those nations where the credit system has received its widest development, and where consequently the spirit of commercial adventure and speculation is most rife, are most exposed to the ravages of recurring periods of bankruptcy.

Money panics are usually preceded by years of active trade, high wages, multiplication of new enterprises, and general prosperity. Each period of abnormal and exciting prosperity is followed by a violent collapse, resulting in increased rates of interest, closing of factories, failures of mercantile houses, and enforced idleness of large numbers of people, often resulting in extreme social disturbances. There is no remedy except in the concurrence of mankind to keep out of debt and to avoid all temptation to make gain without equivalent labor. This is impossible, however. Civilization is so interlaced with the credit system that it is idle to talk of abolishing it. The interests of mankind require that it should continue, even at the cost of its abuses.

There is, too, a desire for gain without labor

which is legitimate. Nine-tenths of all the inventions and discoveries which have advanced mankind from the stone age to the age of electricity have had their origin in this desire. It may be, too, that an occasional crisis is a good thing, inasmuch as it shows commercial leaders by an object lesson the influences which tend to make trade successful or disastrous.

§ 73. **Emergency Currency.**—The year 1893 may be taken as an example of a period of financial stringency. Beginning in August of that year, within a single month a currency famine, due to a variety of causes, became general. The banks ceased to loan money, many of them fearing "a run." Interest reached 20, 50, and 100 per cent. The banks of one city refused to accept drafts on another. Some hundreds of banks were compelled to close their doors. The country had been doing ninety per cent of its business upon credit instruments—not actual money, and when these instruments were refused a financial panic was the result. Men preferred currency in hand to the best kind of credit account, and as a result the actual money was locked up in private vaults. Currency became so scarce that it had to be bought as merchandise at a heavy premium. Merchants were forced to send by express the actual bills to meet distant accounts and to pay the expenses of their families at the summer resorts. Checks were useless away from the banks upon which they were drawn. More than $300,000,000 was withdrawn from the banks and hoarded by the owners.

§ 74. **Clearing-House Certificates.**—This situation brought into local circulation several forms of

currency—credit instruments—which were decidedly unique. The most common of these were the emergency clearing-house certificates, their object being to extend indefinitely the brief term of mutual credit involved in all clearing-house settlements. They were in reality not used as currency, but their effect was to add their face value to the volume of currency in circulation, by releasing for use outside that which would otherwise have been reserved for clearing-house settlements. In each instance the use of the certificates was limited strictly to settlement of mutual accounts between members of the particular clearing-house association issuing the certificate. The certificates were issued to banks upon securities which they furnished. Such certificates were also used during the financial depression of 1907-08.

Other devices of similar character were clearing-house due bills. These stated that a certain sum was due by a particular bank to some other or to the order of some individual and usually had the following additional wording: "This due bill is only good when signed by one and countersigned by another authorized person and is payable only in the exchanges through the clearing-house the day after issue."

§ 75. **Bankers' Expedients.**—Another expedient favored in all parts of the country, was the sale by banks of certified checks against themselves for currency denominations, which when signed by the purchaser, were used by him as currency.

Most generally used of all, however, were pay checks in currency denominations, which in scores of manufacturing towns, were the only currency that

was available for weekly payments and cash purchases by wage-earners.

In addition to these well-defined classes, there were others so varied that but a suggestion of them can be made—negotiable certificates of deposit; ninety-day and other short time paper in currency denominations; bond certificates; grain purchase notes; credit and corporation store orders; improvement fund orders; teachers' warrants; shingle scrip, etc. In every case where the associated banks of a section failed to supply the needed currency, individuals and corporations were compelled to resort to extraordinary devices. This illegal bank-note currency was accepted by the community, the financial conditions became normal again, and every credit instrument was made good in actual money.

§ 76. **Trust Companies.**—The ordinary trust company with which city people are familiar is very similar in its management to a national bank. It invests its deposits and capital in the same class of securities, and is equally careful and conservative in the matter of its loans. It receives money on deposits which exceed a nominal sum—usually from $300 to $1,000. Trust companies are organized under and are subject to state laws. They have connection with the clearing-houses either direct or through some convenient national bank.

Trust companies are in form of organization very similar to the great joint-stock banks of England. They are usually authorized to receive and hold moneys and property in trust and on deposit from courts of law or equity, executors, and individuals, assignees, guardians, trustees, corporations, and in-

dividuals, and may be appointed by probate courts trustees under any will, upon such terms and conditions as may be agreed upon. They act as trustees for widows or children, take charge of and manage property, and collect interest and rent. They act as transfer agents for railroad and other stock, and as agents for the purpose of issuing, registering, or countersigning the certificates of stock, bonds, or other evidences of debt, and for the payment of dividends. They act as agents or attorneys for the care and management of invested property.

§ 77. **Safe Deposit Vaults.**—Many of the banks, trust companies, and insurance companies make a special feature of renting small safe deposit boxes or drawers in their vaults to any and every person who chooses to pay the rent asked, which depends largely on the amount of space needed and is usually from $3 to $10 for the smallest sized box. It is very convenient for one who has not a safe of his own to have a secure place in which to keep valuable papers.

In many of the large safe deposit vaults there are desks and stationery for customers, so that one may at any time and very conveniently and privately clip coupons, examine one's papers and make entries or indorsements, or add new vouchers, or make changes, as the occasion may require.

§ 78. **Suggestions to Bank Clerks.**—Ability, enthusiasm, tact and determination are as necessary in banking as any other commercial situations. Many of the most successful bankers in the country commenced as messengers and passed from one office to another until they became presidents. It should be the constant endeavor of officers of a bank who

hold superior positions to cultivate and develop the self-respect of their subordinates. Faithful service and manly character in a janitor are entitled to just as much honor and to as full recognition as that rendered by a cashier. The man makes the place, not the place the man.

It is the general opinion of bankers that the demand for the right sort of bank clerk is much in excess of the supply. No young man, however, should think of entering upon banking as a profession, unless he has a real love for the business.

The best position for a young man, and the one affording the largest opportunity for promotion will be that of general assistant. It is considered better to enter upon a clerkship in a small bank than in a very large one, for the reason that the steps in the ladder of success are fewer and closer.

The successful clerk must have a true appreciation of the value of time. Every minute should be strictly given to the work of the bank. In the matter of promptness the higher officers should set a good example for those in subordinate positions. There are exceptions, but as a rule promotions are not the result of chance. The man in any calling who has the ability and the desire to do greater things will sooner or later be called upon to do them.

Questions for Review, Chapter III.

1. How are national and state banks respectively organized?
2. What are the duties of the ordinary officers of a bank?
3. What is the actual usable cash of a bank represented by?

4. What are the regulations regarding the redemption of mutilated bills?

5. In what form are United States notes printed?

6. What is meant by "accurate" interest?

7. What is the character of the great bulk of the loans made by banking institutions?

8. What is the nature of a trust company?

9. What is the advantage to the business community of safe-deposit vaults?

10. What kind of bond is usually given by bank clerks and officers?

11. What kind of currency is often issued during periods of financial stringency?

12. What is the nature of the usual organization of a savings bank?

13. What is the usual cause of financial panics?

14. What qualifications are desirable in the employees of a bank?

CHAPTER IV

Deposits and Depositors

Section 79. Opening a Bank Account.—When you enter a bank to open an account, inquire for the cashier or, in the case of a large bank, the person in charge of new accounts; and, if possible, take with you some one who can introduce you and identify you as the person you profess to be.

If you go alone, do not feel hurt if a number of pertinent questions are asked you. While you may be perfectly honest, the bank knows a large number of people make their living by their wits, so-called; and, besides, it is necessary to establish those confidential relations which ought to exist in all financial transactions so that the banker may know something more about you than he could ascertain by merely looking at you, and taking your name in a book.

The cashier or other officer will have you place your signature on a card or in a book. Your name as written in this way should be the same in style as you intend to place on your checks.

If necessary, some officer of the bank will show you how to make out a deposit slip. He will give you

also a small bank book, in which you will be credited with the amount of money which you deposit. Each time you deposit money you will be required to make out a deposit slip. The banks furnish the printed blanks free.

§ 80. **Deposit and Withdrawal.**—Your bank book is your only receipt from the bank for the money you deposit. When you deposit money, hand it to the receiving teller with the funds and deposit slip; and when you wish to draw money, present your check to the paying teller.

When you wish to have your bank book balanced, hand it to the receiving teller. This is usually done on the first of each month. The paid or canceled checks are returned to you in a day or two when you get your bank book back. These should all be filed in an orderly way. They serve as vouchers and may be useful in legal complications.

§ 81. **Depositors' Monthly Statement.**—Most of the city banks now furnish depositors with a monthly statement of their account, showing in detail the amount of all deposits and checks paid, also the balance remaining to the depositor's credit on the last day of the month. The paid or canceled checks are returned with this statement on about the first of each month; and where this system is followed it is not necessary to present the bank book in order to have it balanced, for the bank book shows only the amount of deposits and answers no other purpose than a receipt.

§ 82. **Arranging the Deposits.**—Do not wait until you get to the bank to count your money, or to in-

dorse your checks and arrange your deposit. This should be done before you go to the bank, or at least, before you present yourself at the receiving teller's window. Be sure that you have the figures correct. Place the bills all one way, right side up. Separate your gold and silver, and sort the silver by denominations.

Do not deposit dimes, nickels, and pennies until you have a certain amount of them, say five dollars of each; then put them in a package, with the amount and your name marked on it, and leave for the teller to count at his leisure, with the understanding that if short or over the proper correction will be made.

§ 83. **Bank Checks.**—A check is an order for money by one who has funds in the bank, payable on demand. It is in reality a sight draft on the bank. Banks provide blank checks for their customers, and it is a very simple matter to fill them out properly. In writing in the amount begin at the extreme left of the line. Remember that if a poorly written check should fall into the hands of a fraudulent receiver, who might alter its wording and figures and then get the check cashed, the maker, and not the bank, would become responsible for the loss. You cannot hold the bank responsible for your carelessness. A check was raised from $100 to $190 by writing "and ninety" after the words "one hundred." One of the ciphers in the figure was easily changed to a "9" by adding a tail to it. It is wise to draw a running line——————— after the amount in words, thus preventing any additional writing.

Checks should be dated, but the absence of a date does not warrant a bank in refusing to cash the check. Notes made and executed on Sunday are invalid, but a check so dated is good.

The signature should be in your usual style familiar to the paying teller.

A check is an order on a bank, and need not necessarily be written in the prescribed form. Such an order written on a sheet of note-paper with a lead pencil might be in every way a legally good check.

If it is necessary at any time to write a check for a fractional part of a dollar, as 75cts., write "Seventy-five Cents," and draw your pen through the printed word Dollars.

There hangs in the office of the Pacific Mills, Boston, the canceled check of the United States for one cent; and on the walls of the Bank of Commerce, New York City, hangs a handsomely framed check for $14,000,000, signed by the well-known banking house of Kidder, Peabody & Co.

Usually checks should be drawn "to order." The words, "Pay to the order of John Brown" mean that the money is to be paid to John Brown or to any person he orders it to. If a check is drawn "Pay to Bearer," any person, that is the bearer, can collect it. The paying teller may ask the person cashing the check to write his name on the back, simply to have it for reference.

In writing and signing checks use good black ink and let the copy dry a little before a blotter is used.

§ 84. **Safety Devices for Checks.**—Safety devices to prevent the fraudulent alteration of checks are of

almost endless variety, but there has hardly been a preventive against forgery and alterations yet invented which has not been successfully overcome by swindlers. Machines for punching out the figures are in common use, but the swindler has successfully filled in the holes with paper pulp and punched other figures to suit his purposes. Some of the latest devices, however, are ingenious and probably hard to beat.

The method adopted by the express company and by the post office department in its money orders is perhaps the best plan yet offered to prevent the raising of the amount of a check or order. A glance at an express money order will illustrate this point. Notice the printed line on the left end—"Not payable for more than One Dollar" or "Five Dollars," as the case may be. To raise such an order it would be necessary to add to the length of the paper, which of course would be impossible.

The most experienced bankers favor a plain black and white check, drawn upon clear white paper with good strong black ink.

§ 85. **When Figures and Words Disagree.**—There are often presented to banks for payment, checks in which the figures in the margin do not correspond with the amounts stated in writing in the body of the checks. The law governing cases of this sort provides distinctly that the amount in writing shall be considered correct. If the amount of money involved were large, the paying teller would be justified in withholding payment until he satisfied himself that the amount in writing was what the maker really intended the check to call for.

§ 86. Identification of Check-Holders.—The banks of the United States makes it a rule not to cash a check that is drawn payable to order, unless the person presenting the check is known at the bank—or unless he satisfies the paying teller that he is really the person to whom the money is to be paid. It must be remembered, however, that a check drawn to order and then indorsed in blank by the payee is really payable to bearer, and if the paying teller is satisfied that the payee's signature is genuine he will not likely hesitate to cash the check. In England, all checks apparently properly indorsed are paid without identification.

In drawing a check in favor of a person not likely to be well-known in banking circles, write his address or his business after his name on the face of the check. For instance, if you write the check to John Smith, Boston, it may possibly fall into the hands of the wrong John Smith; but if you write the check in favor of "John Smith, 849 Tremont St., Boston," it is more than likely that the right person will collect it.

If you wish to get a check cashed where you are unknown, and it is not convenient for a friend who has an account at the bank to go with you for the purpose of identification, ask him to place his signature on the back of your check, and you will not likely have trouble in getting it cashed. By placing his signature on the back of the check he guarantees the bank against loss. A bank is responsible for the signatures of its depositors but it cannot be supposed to know the signatures of indorsers. The reliable identifier is in reality the person who is responsible.

§ 87. **Check Indorsements.**—In indorsing checks note the following points:

(a) Write across the back—not lengthwise.

(b) If your indorsement is the first, write it an inch or two from the top of the back; if it is not the first indorsement, write immediately under the last indorsement.

(c) Don't indorse wrong end up; the top of the back is the left end of the face.

(d) Write your name as you are accustomed to write it, no matter how it is written on the face. There is a modern tendency to make the indorsement agree in all respects with the name of the payee as written on the face, but the practice of changing one's signature to conform with the whim, the carelessness or the error of another, is not to be recommended. The bank knows your regular signature, If you wish, however, you can first indorse the check with your name as written on the face, then write your usual signature below.

(e) If you are depositing the check, write or stamp "For Deposit" over your signature. This is hardly necessary if you are taking the check yourself to the bank. A check with a simple or blank indorsement on the back is payable to bearer, and if lost, the finder might succeed in collecting it, but if the words "For deposit" appear over the name, the bank officials understand that the check is intended to be deposited, and they will not cash it.

(f) If you wish to make the check payable to some particular person by indorsing, write "Pay to ....(Name)................ or order," and underneath

this write your own name as you are accustomed to sign it.

(g) Do not carry around indorsed checks loosely. Such checks are payable to bearer, and may be collected by anyone.

(h) If you receive a check which has been transferred to you by a blank indorsement, and you wish to hold it a day or two, write over the indorsement the words "Pay to the order of....................(yourself) ...."

This is allowable legally. The check cannot be collected until you indorse it.

(i) An authorized stamped indorsement is as good as a written one. Whether such indorsements are accepted or not depends upon the regulations of the clearing-house in the particular city in which they are offered for deposit. In New York City and Chicago the use of stamped indorsements is universal. The written indorsement is safer for transmission of out-of-town collections.

(j) If you are indorsing for a company, or society, or corporation, write first the name of the company and then your own name followed by the word "Treas."

(k) If you have power-of-attorney to indorse for some particular person, write his name followed by your own, followed by the word "Attorney" or "Atty." as it is usually written.

(l) Where checks are sent out by the receiving (deposit) bank to all parts of the country for collection, it is customary for the bank to stamp upon the back of the check the words "Indorsement Guaran-

teed." Sometimes a check reaches a bank through responsible parties, who are not its payees, without bearing the payee's indorsement. The bank may decide to pay without demanding the absent indorsement, since such a demand would cause considerable delay and trouble, if the presenter or the presentee of the check guarantees the absence of the indorsement. This he does by writing "Absence of indorsement guaranteed," with his signature, on the back of the check. Of course, this is practically a guarantee against loss and trouble to the banker, which might result from the absence of the indorsement. The banks of some cities will not accept such guarantee. It is sometimes permissible to indorse the payee's name "by............(your own name)................" This may be done by a junior member of a concern when the person authorized to indorse checks is absent, and the checks are deposited and not cashed. If a check lacks the indorsement of the original payee, it may be wise, if convenient to do so, to get it certified before sending it back for such indorsement.

(m) Write your check payable to the order of some person, but don't write "Pay to the order of James Johnson, for grocery bill, April, 1922." Such information on a paid check may serve some purpose of yours, but it is not good business. Descriptive and qualifying matter is quite proper in a letter accompanying the check, and if the letter has been duplicated it is just as legally valuable.

(n) Do not write any unnecessary information on the back of your check. A story is told of a woman who received a check from her husband, and

when cashing it wrote "Your loving wife" above her name on the back.

§ 88. **Cashing Your Own Check.**—If you wish to draw money from your own account, the most approved form of a check is written "Pay to the order of Cash." This differs from a check drawn to "Bearer." The paying teller expects to see yourself or some one well-known to him as your representative, when you write "Cash," or else he knows that you have cashed it yourself with some third party to whom you are known. If you write "Pay to the order of.................... (your own name) ...." you will be required to indorse your own check before you can get it cashed.

§ 89. **Checks for Special Purposes.**—If you wish to draw a check to pay a note, to draw money for wages, or to pay a draft which you are buying, the custom is to make the check payable to the particular bank with which you are dealing.

§ 90. **No Funds.**—If you have deposited a check and it is returned through your bank marked "No Funds" or N. S. F. (not sufficient funds), it signifies that the check is worthless and that the person upon whose account it was drawn has no funds or insufficient funds to meet it. Your bank will charge the amount to your account.

The best thing to do in such a case is to hold the check as evidence of the debt and write the person who sent it to you giving particulars and asking for an explanation. There is no advantage in having the check protested unless it has an indorser other than yourself. One of the banker's journals gives an instance of a man who had a check for $900, which

he took to get cashed. He learned that the drawer had only $700 on deposit, and knowing that he (the drawer) was embarrassed financially, the man deposited to the drawer's credit $200 of his own money, and then presented his $900 check and had it cashed, holding the drawer liable for the $200.

§ 91. **Stopping Payment.**—If you wish to stop the check which you have issued, you should notify the bank at once, giving full particulars of the check. Its payment will then be refused by the bank.

§ 92. **Canceling Checks.**—Banks have a custom, after paying and charging checks, of canceling them by punching or by making some cut through their face. These canceled checks are returned to the makers at the end of each month, as before stated.

§ 93. **Checks Presented After Death.**—As a general rule banks are expected to stop the payment of a check the signer of which has died before its presentation. This is not always possible, for the reason that information as to the death of a customer may not reach the bank for days, so that in reality banks are every day paying checks of men who are dead. In Massachusetts, checks are good for ten days after the death of the signer.

§ 94. **Checks Should Be Numbered.**—Checks should be numbered so that each can be accounted for. The numbers are for your convenience and not for the convenience of the bank. It is important that your check-book be correctly kept, so that you can tell at any time how much money you have in the bank.

At the end of each month, your bank book, if balanced, or your monthly statement may (and usually does) show a larger balance than your check-book. You will understand by this, if both have been correctly kept, that there are checks outstanding which have not yet been presented at your bank for payment. You can find out which these are by checking over the paid checks that have been returned to you with your bank-book or statement. The unpaid checks may be presented at any time, so that your actual balance is that shown by your check-book.

Checks should be presented for payment as soon after date as possible.

§ 95. **Certificate of Deposit.**—If you deposit money temporarily in a bank for safekeeping you will receive a receipt therefor. This receipt is usually called a certificate of deposit. Interest is allowed under certain conditions. It is practically a bank's check on itself. In issuing certificates of deposit to strangers the bank should take their signatures upon the margin of the certificate book, so that, when the certificates come home for redemption, the indorsement may be compared with this original signature, if it seems necessary. Of course every properly managed bank has a ledger account of certificates of deposits issued, which is a full record of the amounts and numbers. Returning certificates can be compared with this record as they are presented for payment through clearing-houses and over the counter.

§ 96. **Certified Checks.**—If you wish to use your check to pay a note due at some other bank, or in buying real estate, or stocks, or bonds, you may find

it necessary to get the check certified. This is done by an officer of the bank who writes or stamps across the face of the check the words "Certified" or "Good when properly indorsed," and signs his name. The amount will immediately be deducted from your account, and the bank, by guaranteeing your check, becomes responsible for its payment. Banks will usually certify any check drawn upon them if the depositor has the amount called for to his credit, no matter who presents the check. If you should get a check certified and then not use it, deposit it in your bank, otherwise your account will be short the amount for which it is drawn. In Canada, all checks are presented to the paying teller.

§ 97. **Bank Drafts.**—Your bank check, while it is your sight draft on your bank, differs from an ordinary commercial draft, not only in its wording, but in its purpose. A check is used for paying money to a creditor, while a draft is used as a means of collecting money from a debtor. The bank is obliged to pay your check if it has funds of yours sufficient to meet it, while the person upon whom your draft is drawn may or may not honor it at his pleasure.

Banks keep money on deposit in one or more other banks located in some of the commercial centers. Nearly all large banks keep money on deposit with one or more of the New York City banks. They call these banks their New York correspondents.

A bank draft is simply the bank's check, drawing on its deposit with some other bank. Banks sell these checks to their customers. Merchants make large use of these drafts, or cashier's checks as they are sometimes called, in making remittances from

one part of the country to another. These drafts or checks pass as cash anywhere within a reasonable distance of the money center upon which they are drawn. Banker's drafts on New York would, under ordinary financial conditions, be considered cash anywhere in the United States.

A draft on a foreign bank is commonly called a bill of exchange. Bills of exchange are usually drawn in duplicate, one of which is forwarded and the other retained. They are so worded that when the original is paid the duplicate becomes void. They are drawn in the currency of the country where they are made payable. These drafts are used to pay accounts in foreign countries just as drafts on New York are used to pay indebtedness at home. See chapter on Foreign Exchange.

§ 98. "Kiting" Checks.—Don't exchange checks to get twenty-four hours' credit. This is often done. The banks call it "Kiting." If your bank finds that kiting is included in your business methods do not be surprised if you are asked to withdraw your account. Banks cannot afford to lend you money even for twenty-four hours without interest or security.

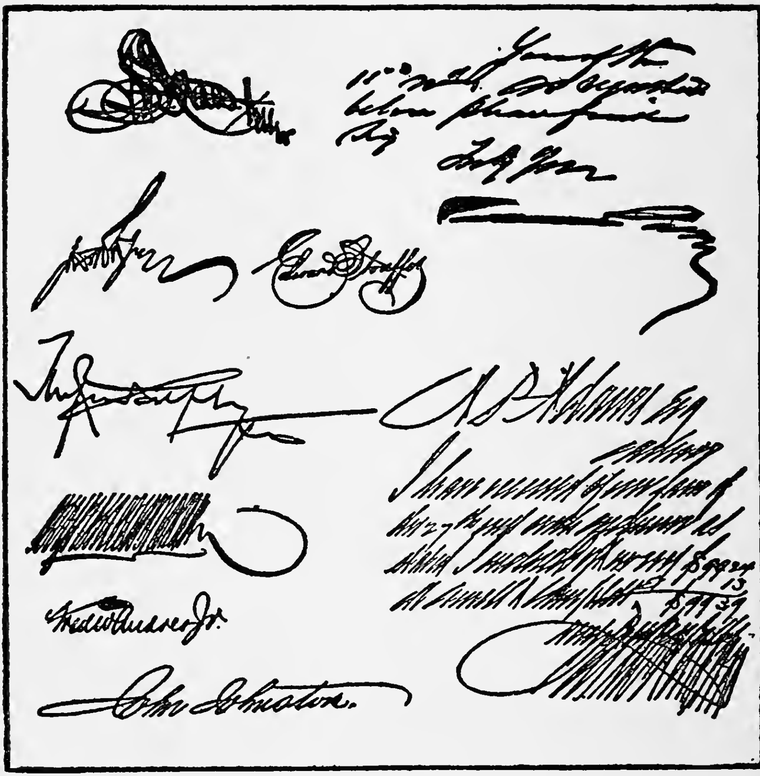
To illustrate, suppose it is 12 o'clock noon—after the bank clearing at the clearing-house. A is short and needs $500. He gives B his check for $500 and takes B's check for $500. B's check may not be any better than A's, but A deposits it and has ample time before three o'clock to draw on the deposit and use some of the money. B may do the same with A's check. Other checks or cash are deposited in the morning before clearing-house hours so that the $500 checks may be met when they come in for col-

lection. A may accomplish the same end by having accounts in two banks and by deposting a check on the one in the other.

§ 99. **Forged Checks.**—Who is liable when a forged check has been paid? This question is often asked, and the answer varies with circumstances. Ordinarily the bank must stand the loss, but if the fraud is the result of carelessness on the part of the person whose name is forged, the bank is not liable. Business men should not only make use of the most approved methods of protecting their checks but they should take every possible precaution to prevent improper use of the blank forms by keeping them in places inaccessible to anyone but those of their own counting-rooms who are authorized to write up their checks.

§ 100. **Personal Signatures.**—In the course of business we often come across very queer specimens of writing and eccentricities in signatures. A New York Insurance Company's vice-president had a signature, as it appeared on the policies issued by his company, which was fourteen inches one way and nine inches the other. In our illustration the signature at the top of the left is that of F. S. Watte, teller of an Iowa bank. Immediately under this name is that of John Mohr, Jr., cashier of a bank in Indiana. Under Mohr's signature is that of Tom Randolph, president of a bank in Texas. Directly under Randolph's signature we find a cross-etching which represents the treasurer of a manufacturing company in Connecticut—Hugh Harbison. It ranks high as a curiosity in penmanship. The writing at the upper right-hand corner is that of Carmon Parse,

cashier of a bank in New Jersey. The writing in the lower right-hand corner filled the entire page of a letter sheet. The name is that of Jas. V. D. Westfall.



These specimens are interesting, but after all the best form of signature, and the one most difficult to forge, is that written in a plain business style, such as "John Johnston" in the illustration.

Business men and bankers are as thoroughly familiar with the signatures of other business men as they are with their faces.

§ 101. Suggestions to Bank Depositors.—Don't exaggerate your financial condition. The bank has a history of it on its books.

Do not borrow money to swell your deposits.

Don't ask for special favors in the way of credit; good security is all the bank asks. Your intercourse with bank officers should be candid and courteous.

Make your deposit as early in the day as possible. Never exchange checks to make large deposits. Never make deposits without your bank book. Avoid unnecessary conversation with the clerks.

Make it an invariable rule to give checks only out of your own check book. Never give out checks dated ahead. Always consider a check paid when you give it out and mark the amount from your balance.

Let all your dealings be strictly honorable.

Do not draw a check unless you have the money on deposit.

Do not test the generosity of your bank by presenting, or allowing to be presented, your check for a larger sum than your balance.

Do not draw a check and send it to a person out of the city expecting to make good the amount before it gets back.

Do not give your check to a friend with the condition that he is not to use it until a certain time.

Do not send ignorant and stupid messengers to the bank to transact your business.

Questions for Review, Chapter IV.

1. What course is followed by a business man in opening an account in a bank?

2. What is the legal nature of a bank check?

3. What is the purpose of the depositor's bankbook?

4. Who is responsible for any loss in case of the fraudulent "raising" of a check?

5. Is a check dated on Sunday good?

6. Is a note executed on Sunday good?

7. Must a check necessarily be written on a printed form?

8. Why should a check usually be drawn "to order"?

9. Is it ever a good plan to place the address of the payee on the face of a check?

10. What is the correct method of indorsing a check?

11. How would you write a check to draw money for wages of employees?

12. How would you draw cash for your own use?

13. If you have power of attorney to indorse for a person, how do you sign your name?

14. Is a stamped indorsement of a check as good as a written one?

15. What should be done in case a check is returned marked "no funds"?

16. How are checks "certified"?

17. What is meant by "kiting" checks?

18. What is the best form of signature for a check, and the kind most difficult to forge?

CHAPTER V

Notes and Drafts

Section 102. Promissory Notes.—A promissory note is a written promise to pay a specified sum of money. At the time of the note's issue, that is, when signed and delivered, two parties are connected with it: the maker and the payee. The maker is the person who signs or promises to pay the note, and the payee is the person to whom or to whose order the note is made payable.

Negotiable in a commercial sense means transferable and a negotiable note is a note which can be transferred from one person to another. A note to be made negotiable must contain the word order or the word bearer, that is, it must be payable either to bearer or to the order of the payee.

A non-negotiable note is payable to a particular person only.

A note may be written on any kind of paper in ink or in pencil.

§ 103. Date of a Note.—The date of a note is a matter of the first importance. Some bankers and business men now consider it better to draw notes and time drafts payable at a certain fixed time; as, "I promise to pay on the 10th of March, 19——."

The common custom, however, is to make the notes payable a certain number of days or months after date.

A note made and issued on Sunday is void.

The day of maturity is the day on which a note becomes legally due. In most of the states a note is not legally due until three days, called days of grace, after the expiration of the time specified in the note.

The words "without defalcation" are inserted in Pennsylvania notes.

§ 104. **"Value Received."**—These words are not legally necessary, although they usually appear on ordinary promissory notes. Thousands of good notes made without any value consideration are handled daily.

The promise to pay of a negotiable note must be unconditional. It cannot be made to depend upon any contingency whatever. A note made payable in anything but money is simply a form of contract and is not a negotiable instrument.

§ 105. **Accommodation Paper.**—Notes and acceptances that are made in settlement of genuine business transactions come under the head of regular, legitimate business paper. An accommodation note, is one which is signed, or indorsed, or accepted, simply as an accommodation, and not in settlement of an account or in payment of an indebtedness.

Accommodation paper has a deservedly hard reputation with banks. However, there are all grades and shades of accommodation paper, though it represents no actual business transaction between the

parties to it, and rests upon no other foundation than that of mutual agreement.

§ 106. **Title of Third Parties.**—No contract is good without a consideration, but this is only true between the original parties to a note. The third party or innocent receiver, or holder of a note, has a good title, and can recover its value, even though it was originally given without valuable consideration.

An innocent holder of a note which had been originally lost or stolen, has a good title to it, if he received it for value.

§ 107. **Interest Notes.**—A note does not draw interest until after maturity, unless the words with interest appear on the face. Notes draw interest after maturity and until paid, at the legal rate.

§ 108. **Indorser of a Note.**—An indorser of a note is any person who writes his name on the back of it, and by so doing guarantees its payment. Indorsements on notes are usually made in blank, that is, without the words "Pay to the order of." The receiver of the note is then free to indorse it or not at his pleasure if he wishes to transfer it.

The indorser is liable for its payment if the maker fails to meet it. If an indorser should be compelled to pay a note he has a good claim against the maker, and against each indorser whose name appears above his own.

An indorser to whose order a note is drawn or indorsed, can transfer it without becoming liable for its payment by writing the words "without recourse" before or after his name on the back.

A person who receives a promissory note in good faith for fair value before the day of maturity, takes it free from all defects of title and from all claims that might be set up against any preceding holder. This is not true of notes transferred after maturity.

§ 109. **Presentation for Payment.**—A note should be presented on the exact day of maturity. Notes made payable at a bank or at any other place, must be presented for payment at the place named. When no place is specified the note is payable at the maker's place of business or at his residence.

The note must not be presented before or after maturity but upon the exact day of maturity, if the indorsers are to be held liable for its non-payment.

§ 110. **Protest.**—When a note is presented for payment at maturity and is not paid, it is usually protested, that is, a notary public makes a formal statement that the note was presented for payment and payment was refused. Notice of such protest is sent to the maker and to each indorser.

The bank should never hand to its notary any paper for protest until it has made sure that its non-payment has not been brought about by some error or misunderstanding. Quite often, even though the paper has been made payable at the bank, the notary sends a messenger with the note to the maker to make a formal demand for payment.

In taking a collection paper, banks should obtain clear instructions from its owners as to whether or not it should be protested in case of non-payment. It by no means follows that a formal protest is not

desired because the paper bears no indorsements.

Many banks make it a rule to protest all unpaid paper unless otherwise ordered.

§ 111. **Date of Maturity.**—In finding the date of maturity it is important to remember that when a note is drawn "days after date" the actual days must be counted, and when drawn "months after date" the time is reckoned by months.

§ 112. **Payment on a Note.**—If a payment is made to apply on a note, such payment should always be indorsed on the back of the note. Such indorsement requires no signature. The usual form is to give the date and write "Received on within note," stating the amount. An ordinary separate receipt is not sufficient. Each amount indorsed on the back reduces the face value.

§ 113. **A Joint Note.**—A note having two or more makers is called a joint note. If written "We jointly and severally promise to pay," either maker is individually liable for the whole amount if the other does not pay his share; if written "We promise to pay," each is liable for his one-half.

A note written "I promise to pay," and signed by two or more persons is a joint individual note.

§ 114. **Signature to a Note.**—The maker's signature to a note must appear in some form upon some part of the paper. It may be affixed by himself or his authorized agent, and it may be the full name or the initials only.

§ 115. **Commercial Drafts.**—A commercial draft is really a letter from one person to another request-

ing that a certain sum of money be paid to the person who calls or to the bank or firm for whom he is acting. Commercial usages recognize a particular form in which this letter is written and the address of the person for whom it is intended is usually written at the lower left-hand corner instead of on an envelope.

Commercial drafts are sent through the banks instead of directly through the mail. For instance, if A of Boston owes B of New York $100, B may draw on A for the amount. He may deposit the draft in a New York bank to be forwarded or he may mail it himself to a Boston bank for collection. When the draft reaches the Boston bank, a messenger will carry it to A. If it is a sight draft, that is, if B wants the money paid at sight, immediately, A may give the money to the messenger and take the draft as his receipt. If it is a time draft, that is, if B gives A time, a certain number of days in which to pay the draft, A accepts it. He does this by writing the word accepted with the date and his signature across the face of the draft. He then returns the draft to the messenger and it is returned to B. An accepted draft is really a promissory note, though it is often called an acceptance. When a man pays or accepts a draft he is said to honor it. In this instance A is not obliged either to pay or to accept the draft. It is not binding on him any more than a letter would be. But, if he refuses to honor legitimate drafts, it may injure his credit with the banks and other business houses. See chapter on Credit and Exchange.

§ 116. **Collections by Draft.**—It is a very common thing to collect distant accounts by means of commercial drafts. A debtor is more likely to meet a draft than he is to reply to a letter and inclose his check. It is really more convenient and safer too, for there is some risk in sending personal checks through the mails. There are some houses that make all their payments by check, while there are others that prefer to have their creditors at a distance draw on them for the amounts due.

If a business man who is accustomed to honor drafts continues for a period to dishonor them, the banks through which the drafts pass conclude that he is unable to meet the payments. Circumstances of this character have a tendency to injure one's credit.

The messenger from a bank who presents a sight draft is not authorized to accept a check in payment, but the person upon whom the draft is drawn may, if he chooses, write across the face, Accepted, July —, 19—, payable at First National Bank," and under this write his name. Such a draft is then really a check—an order on his bank to pay the amount due for him, and the particulars must be entered in the check-book just the same as though an actual check had been issued.

Some houses deposit their drafts for collection in their home banks, while others have a custom of sending them direct to some bank or near the place where the debtor resides. If the place is a very small one the collection may be made through one of the express companies.

§ 117. **Draft Notices.**—When goods are sold for distinct periods of credit and it is generally understood that maturing accounts are subject to sight drafts, there really should be no need of notifying the debtor in advance of drawing. Some houses, however, make a general custom of sending notices ten days in advance stating that drafts will be drawn if check is not received in the meantime. These notices may be often seen printed at the foot of statements sent out on the first of the month.

§ 118. **When are Accounts Due?**—Custom has made some rules which are now considered absolute by the business houses. On general monthly credit accounts, all goods bought during the month are due on the first day of the month following and may be paid any time between the first and the tenth. Goods sold for cash should be paid for at once or within ten days from the date of sale.

If a discount is allowed for cash that discount can be claimed and is usually allowed if payment is made within 10 days. Goods bought on March 3 at 30 days would be due April 3 plus 10 days, or April 13. That is to say, if a discount were allowed for payment within 30 days the discount could be claimed if payment were not made until April 13.

It is a common custom to date sales ahead, to the first of the next month, or sometimes two or three months ahead. The dates of drafts then conform to the general custom of credits.

§ 119. **Collections Through Banks.**—If you desire to have your bills receivable, and commercial drafts collected through a bank, you should place

them with the bank at least fifteen days before maturity. About ten days before maturity the bank will send to the maker a formal notice stating that they hold a note against him, giving the amount and date of maturity, and asking him to call and pay it.

When a note is left at the bank for collection, it should be indorsed "Collected for account of———." By this indorsement the note is not transferred to the bank. The bank is simply authorized to collect the amount.

§ 120. **Three-Party Draft.**—If the drawer of a draft owes some one in the same city with the person upon whom he draws, that is, if he has a creditor and a debtor in the same city, he can draw on the debtor in favor of the creditor and forward the draft by mail to the creditor. The creditor will deposit it for collection in the ordinary way, usually after indorsing it.

§ 121. **"No Protest."**—We often see attached to the end of the draft a little slip with the words "No Protest; tear this off before presenting." This is simply private advice to the banker informing him that the drawer does not wish to have the draft protested. It may be that he does not wish to wrong, or injure the credit of, or add to the expense of his debtor, or it may be that he considers the account doubtful and does not wish to add to his loss that of protest fees.

§ 122. **Discounting Drafts.**—It is a common thing to have drafts discounted before they are accepted. For instance, a wholesale merchant may have accounts out amounting to $100,000 and he

may need immediate working capital. He draws on his customers and sells his drafts to a bank either directly or through a note broker. The amount of discount depends upon the money market. The drafts are as good as one-name notes. Some of them, of course, will be dishonored, but these are met by the drawer as soon as returned, or he may set aside an agreed-upon percentage of the entire amount to cover the drafts likely to be returned.

Drafts attached to bills of lading and other securities are frequently discounted when placed in the hands of the bank. Such drafts are usually drawn at sight or at one day.

§ 123. **Advantages of Taking a Note.**—It is generally understood that a debtor is more likely to pay a promissory note than he is to keep a simple verbal promise. It will injure his credit if he allows his paper to go to protest. It is difficult, too, to dispute a claim after a note has been given in settlement. The note may also be used by the creditor in raising money for his own use; that is, he may get it discounted—sell it to a note-broker or to a bank.

But there are some disadvantages. If a note is accepted from a debtor the amount cannot be collected until the day of maturity of the note. You may hold a note against a debtor, and if your note is not due, you cannot by any process of law prevent your debtor from selling everything he owns and leaving for parts unknown.

A note that is overdue is in some particulars better than a note not yet matured. An overdue note draws interest at the legal rate from the date of

maturity and legal steps to collect it may be taken at any moment.

§ 124. **Discounting Paper.**—To discount a note or draft is to sell it at a discount. The rates of discount vary according to the security offered, or the character of the loan, or the state of the money market. For ordinary commercial paper the rates run from 4 to 8 per cent. Notes received and given by commercial houses are not usually for a longer period than four months.

§ 125. **Drafts and Bills of Lading.**—The use made of commercial drafts in connection with bills of lading is quite interesting. For instance, the live cattle are paid for in Texas by the proceeds of a draft, with bill of lading attached, upon Chicago, where they are slaughtered. Bills of lading for the dressed beef shipped East are accompanied by drafts on New York, and the shipment per steamer to Liverpool or Glasgow is drawn against, in sterling, upon London. The latter draft is sold to a New York banker, who in turn draws against it in favor of merchants who are buying foreign exchange.

§ 126. **Overdue Paper.**—Negotiable paper, whether made for accommodation or otherwise, may be transferred by endorsement and delivery or by delivery alone either before it has fallen due or afterward. There is a difference, however, in the liability attached to indorsers, and the value of the paper may be affected by the defenses existing between the original parties. It would be well to consult a lawyer before accepting overdue paper, particularly if it has indorsers.

§ 127. **Who is a bona-fide Holder?**—If the indorsee or holder of a note has no notice at the time he receives it, of any facts or circumstances that would prevent any of the parties to the paper before him from recovering the whole amount, he is a bona-fide or innocent holder, and if he has paid for the note, he is a holder for value, and can recover its full face.

An alteration or change in some material part of a promissory note, by a party to it, makes the paper void as regards all parties except those who assent to the change. Adding an interest rate is a change,

§ 128. **A Set-off.**—If a man has a claim against you and you also have a claim against him, you call your claim a set-off, that is something to set or cancel off part or all of his claim. Under ordinary conditions it is impossible to have a set-off against a note not in the hands of the original payee.

§ 129. **Notice of Non-payment of a Note.**—If the note has been discounted or is in a bank for collection, the bank will send notice to the indorsers to the effect that the note has been presented for payment and payment was refused. If the note is in the holder's hands and payment, upon presentation, has been refused, the holder should immediately send a written notice to the indorser, if any, stating that "a certain note made by————, for————, in favor of ————dated ————," and "by you indorsed" was "this day presented to———— for payment, and payment was refused." Such notice may be sent by mail.

§ 130. **A "Mark" Signature.**—When a man who cannot write is asked to sign a deed or mortgage or other legal document, the usual custom is to have

him affix a cross, some one doing the writing for him. Such a signature should be witnessed. An indorsement of this kind is legal and is quite common. There are no legal rules covering the shape of the mark. The man's name should be written around or near the mark, thus: "Charles Clark (X) his mark."

§ 131. **Power of Attorney.**—To give some one else the power to sign or indorse checks, notes, or other important papers, is called giving such a one power of attorney, that is, the power or authority to be your attorney. Such authority when given should state explicitly what the attorney has power to do.

The Post Office Department issues a printed blank for use by those who wish to transfer to others the power to sign money orders.

Powers of this sort should be filed with the post-office or bank interested, or should be made matters of public record at the office of the register of deeds.

§ 132. **Return of Vouchers.**—Banks usually return to promisors and acceptors all the paper which they have collected. When you pay a note or draft you expect to receive the canceled note or draft in exchange for the money which you pay. In the same way paid checks are returned to the drawers of them, at the end of each month. This rule is not generally followed, however, between banks and their correspondents.

The canceled note or draft which you receive should not be destroyed. It may serve as an important voucher. A good plan is to tear the signature through the middle and destroy the torn-off

piece. The note is then destroyed as a credit instrument but remains sufficiently complete to serve as a voucher.

§ 133. **Due Bills.**—A due bill is an acknowledgment and evidence of a debt. It may be payable in money or in merchandise. The ordinary form of due bill is not negotiable.

§ 134. **How Notes Differ from Other Contracts.**—There are three peculiarities which distinguish promissory notes from ordinary written contracts.

(a) Notes are negotiable.

(b) There is no statement in a note of consideration.

(c) There are no days of grace allowed on ordinary contracts.

A note must have a clear promise to pay, without any attached conditions. The time must be certain, that is, it must not depend upon the happening of some uncertain event.

§ 135. **Legal Tender.**—In making money payments it is necessary often, or if the receiver demands it, to make payment in legal tender, that is, in the form of money required by law. For instance you cannot pay an amount of $18 in ten cent pieces, if the creditor refuses to accept, for the reason that silver coins of smaller denomination than one dollar are legal tender only in all sums not exceeding $10.

§ 136. **Note Brokers.**—Merchants sell a great many of their notes in the open market, that is, to note brokers. The assistance of the broker who handles commercial paper is a necessary and valuable

aid to the purchasing bank. Most of the paper purchased by New York city banks is purchased upon the simple recommendation of the note brokers. As a rule these brokers simply transfer the paper without guaranteeing, by indorsement, its payment. Notes bought by banks from note brokers without their endorsement are held to be guaranteed by them to be all right, in all points except that which covers the question of whether they will be paid or not. The bank uses its best judgment in taking the risk.

If the note dealer, in selling notes to a bank, makes what he believes to be fair and honest representations regarding any particular paper, statements of such straightforward type that upon them no charge of false pretenses can be made to rest, he simply guarantees the note genuine as to names, date amount, etc., and that, in selling it, he conveys a good title to the paper. As business men, however, they are very cautious, and are exceedingly anxious that the paper they sell shall be paid, and as a rule they make good any losses which grow out of apparent misrepresentations on their part.

§ 137. **Single-name Paper.**—The custom of issuing single-name paper has grown largely of late. The maker is the borrower, and the buyer must consider his personal credit when making the purchase. It is estimated that two-thirds of all the paper bought by New York city banks is single-name. Such paper makes no pretense to be anything else but what it appears, a simple promise to pay, and in this it differs from accommodation paper. Genuine double-name paper consists of notes given in actual payments of merchandise sales.

§ 138. Demand Collateral Note.—In the case of what is called a demand collateral note, the bank loans money payable on demand and accepts, say, railroad stock as security. The stock is held by the bank until the note is paid, and if not paid, the stock becomes the property of the bank.

§ 139. Waiver of Demand and Notice.—All indorsed demand notes held by a bank should start with a waiver of demand and notice by the indorser, since in time (in some states in 60 days) indorsers are lost—unless a demand for payment is made upon promisors—if this precaution has not been attended to.

§ 140. Judgment Note.—Some of the States have a form of promissory note called a judgment note. In this form of note the maker confesses judgment if the note is not paid and authorizes the court to take possession of sufficient of his property immediately to satisfy the amount of the claim. It is really a very severe form of contract and should be given only under extreme conditions.

Questions for Review, Chapter V.

1. What is the nature of a promissory note?
2. What is meant by the day of maturity of a note?
3. What are "days of grace"?
4. Are the words "Value received" legally necessary on a promissory note?
5. What is meant by "accommodation paper"?
6. Can a third party or innocent holder of a note recover its value even though it was illegally given, without a valuable consideration?
7. When does a note draw interest before maturity?

8. What is the significance of indorsing a note?

9. What is the object of writing the words "Without recourse" before or after an indorser's name?

10. When should notes be presented for payment?

11. What is meant by "protesting" a note?

12. What is the form of a protest notice?

13. What course should be followed after a payment is made to apply on a note?

14. What is the effect of the indorsement of a partial payment on the back of a note?

15. What is the nature of a joint note?

16. What is the usual form or a commercial draft?

17. How are commercial drafts usually collected?

18. What is the advantage of making collections by draft?

19. When should bills receivable and commercial drafts be placed with a bank for collection?

20. What is meant by a three-party draft?

21. What is the meaning of the slip with the words "No protest" often attached to the end of a draft?

22. What are the advantages of taking a note from a debtor?

23. What is meant by discounting a note or draft?

24. How are commercial drafts used in connection with bills of lading?

CHAPTER VI

Credit and Exchange

Section 141. Importance of Credit.—It is to credit alone that we are indebted for that immediate agent who plays so important a part in the transaction of business, whether it be in causing supply and demand to meet, or in applying to the industry of exchange the principle of the division of labor which is so favorable to production.

Without credit this intermediary is impossible in most industries. It gives birth to both industry and trade. It multiplies the producing and consuming power of society; by facilitating exchange it accelerates and increases it.

In reality the largest share of the business of the world is done on a credit basis. In many instances the instruments of payment which we call cash are in reality only promises to pay.

During the Middle Ages credit transactions of great importance and on long time were effected without leaving the slightest trace in writing; and even to this day producers and merchants in some countries contract credit obligations for twelve months' time, without giving the least evidence of the debt, and that for a very good reason—very frequently they can neither read nor write.

§ 142. Instruments of Credit.—When we give credit we give value and wait for the value we are to receive in return; but we often cannot afford to do this, so we get some other person to wait for us by giving him an instrument of credit which we take when we deliver our goods. The person to whom we give the instrument of credit may not be able to wait either, so he takes the paper to the bank and discounts it. It is the business of the bank to wait, not the business of the merchant. The latter should keep his full capital active every day and every dollar he is waiting for is inactive and is earning nothing.

On the other hand the bank increases its capital by waiting, for the simple reason that it charges for waiting just as a lawyer charges for giving his time to his client.

But does this increased circulation increase capital? The machine runs faster and turns out more work, but doesn't increase its size or its intrinsic value; it is the work that counts, not the machine.

§ 143. Development of Financial Exchange.—In early times foreign trade consisted in the direct exchange of commodities. A caravan set out with a variety of manufactured articles, across the deserts of Arabia or Sahara, and came back with ivory, spices, and other valuable raw products obtained by barter. In later times the merchant loaded his own ship and set her forth on an adventure, trusting that his shipmaster would sell the cargo to advantage, and, with the proceeds, bring back another cargo

to be sold to great profit at home. Trade was thus reciprocal, and what we sent out paid for what was brought back.

Wherever this direct reciprocal exchange did not exist it was necessary to devise some mode of transferring debts. To the early Italian and Jewish merchants we owe the development of the use of the credit instruments which have developed into bills of exchange. As early as the fourteenth century bills were used under similar customs and of about the same form as those of the present day.

§ 144. **Principles of Exchange.**—In commerce the term "exchange" is generally used to designate that species of mercantile transactions by which the debts of individuals residing at a distance from their creditors are canceled without the transmission of money. Among cities or countries having any considerable intercourse together, the debts mutually due by each other approach, for the most part, near to an equality.

There are at all times, for example, a number of persons in New York indebted to London, and perhaps, as many persons in London indebted to New York. Hence when A of New York wishes to make a payment to B of London, he does not send the actual money, but he goes into the market and buys a bill of exchange on London; that is, he goes to a New York bank, doing a foreign business, and buys a draft, called a bill of exchange, which is in reality the New York banker's order on his London correspondent, asking the latter to pay the money to the person named.

It may be that about the same time some London merchant who owes money in New York goes to the very same London banker and buys a draft on the New York bank. In this way the one draft cancels the other, and when there is a difference at the end of a week or month the actual gold is sent across to balance the account.

Inland or domestic bills are commonly called drafts. Foreign bills, that is bills on foreign countries, are called exchange.

§ 145. **Par of Exchange.**—The par of the currency of any two countries means, among merchants, the equivalency of a certain amount of the currency of the one in the currency of the other, supposing the currencies of the both to be of the precise weight and purity fixed by their respective mints. Thus, according to the mint regulations of Great Britain and France, £1 sterling was normally (before the World War) equal to 25.2 francs, which was said to be the par between London and Paris. And the exchange between the two countries was said to be "at par" when bills were bought and sold at this rate; that is, for example, when a bill for £100 drawn in London was worth 2520 francs in Paris, and conversely. When £1 in London bought more than 25.2 fr., exchange was said to be in favor of London.

The normal par of exchange between Great Britain and the United States prior to the World War was 4.86 2-3, that is, £1 sterling was worth $4.86 2-3. The effects of the War brought the exchange value of the pound sterling down to as low as $3.49 and exchange

with all the European belligerents sank to a low ebb, with prospects for slow recovery.

Exchange is quoted daily in New York and other city papers at a certain rate in dollars and cents, for sight bills on London and at a slightly lower rate for sixty-day bills. These are the two common kinds of bills usually bought. The sixty-day bills bought in New York are as good as cash when they reach London, but they are cashed at a discount from their face value, unless they are held until the date of maturity.

The foregoing statements explain in a general way the meaning of the par of exchange, but its exact determination, or the ascertaining of the precise equivalency of a certain amount of the currency of one country in the currency of another, is exceedingly difficult. If the standard of one be gold and that of another be silver, the par must necessarily vary with every variation in the relative values of these metals. The value of the precious metals even in contiguous countries, is always exposed to fluctuations from the over-issue or withdrawal of paper, from circumstances affecting the balance of payments. Gold is usually high when there is a demand for gold or a scarcity of it, just as it is in the case of potatoes or wheat. It is obvious, therefore, that it is all but impossible to say, by merely looking at the mint regulations of any two or more countries, and the prices of bullion in each, what is the par of exchange between them.

§ 146. **The Test of Exchange.**—The imports and exports of bullion are the real test of exchange. If bullion is stationary, neither flowing into nor out

of a country, its exchanges may be truly said to be at par; and, on the other hand, if the bullion is being exported from a country, it is proof that the exchange is against it, and conversely if there be large importations.

Variations in the actual course of exchange, or in the price of bills, arising from circumstances affecting the currency of two countries trading together, are nominal only: such as are real grow out of circumstances affecting their trade. When each buys of the other commodities of precisely the same value, their debits and credits will be equal, and the real exchange will be at par. This condition of affairs very rarely happens.

The cost of conveying bullion from one country to another forms the limit within which the rise and fall of the real exchange between them must be confined. If a New York merchant owes a debt in London and exchange costs him, say 2 per cent, and the cost of shipping the gold is only 1 per cent, it will be to his advantage to pay the debt by sending the actual coin across, so that the limit within which trade fluctuations may range corresponds to the actual cost of making remittances in cash.

§ 147. **Effect on Foreign Trade.**—Fluctuations in the nominal exchange, that is, in the value of currencies of countries trading together, have no real effect on foreign trade. When the currency is depreciated, the premium which the exporter of commodities derives from the sale of the bill drawn on his correspondent abroad is only equivalent to the increase in the price of the goods exported, occasioned by this depreciation.

A favorable real exchange operates as a duty on exportation, and as a bounty on importation. It is to the interest of merchants or bankers, who deal in foreign bills to buy them where they can get them the cheapest, and to sell them where they are the dearest. For this reason it might often be an advantage for a New York merchant to buy a bill on London to pay a debt in Berlin. For instance, in the trade between England and Italy the bills drawn on England amount almost invariably to a greater sum than those drawn on Italy. The bill-merchants, however, by buying up the excess of the Italian bills on London, and selling them in France or other countries indebted to England, prevent the real exchange from ever becoming very much depressed.

§ **148. Changes in Exchange Rates.**—Exchange is not affected so much by the balance of trade as by the balance of indebtedness. Europe can contract debts in America by the purchase of stocks, bonds, or other securities as readily as by the purchase of wheat, cotton, or oil, the rate of foreign exchange being similarly affected no matter what is bought. European owners of American securities when sending them to America obtain the right to draw against American receivers of those securities.

One hundred shares of stock sent by a London firm to a New York firm will make as much exchange against New York as the same value of wheat shipped by a New York firm to a Liverpool account; so that the balance of trade, so far as imports and exports are concerned, may appear favorable and yet no balance of indebtedness appear. The movement of merchandise is recorded while the movement of securities

is not recorded. The sum total of our securities in European hands is unknown, but prior to the World War it probably exceeded the amount of our national debt at that time.

The rate of foreign exchange, affected by trade movements and by the movements of securities, is also affected by interest and dividend payments and by remittances for freight on importations of merchandise, the owners of vessels usually being foreigners. Our large cities send annually to Europe drafts for hundreds of thousands of dollars to cover interest on city bonds.

Foreign exchange is affected too, by the difference which exists at any time between the American and European market rate of interest. If money can be loaned at 10 per cent in New York while only 5 per cent can be obtained in London, there is an advantage in keeping or sending money there, the difference in interest being greater than the cost of transportation. The fact of the United States being a gold producing country is also important, for it indicates that a small annual export of gold is to be expected.

§ 149. **Effect of Travel, Etc.**—There is another factor which has a noticeable effect, namely that of travel. Thousands of wealthy Americans travel abroad every summer and the letters of credit which they carry, if not counter-balanced by some other cause, require gold shipments to meet them. Ordinarily when the market rate of demand exceeds normal it is evident that foreign goods have been imported too freely, or American goods are not wanted abroad, or American securities find a better

market here than in Europe, or rates of interest here are too low to attract or keep foreign money, or foreigners are short of money, or there are a great number of Americans abroad, or we have produced a surplus of gold, or freight remittances are large, or interest payments on securities owned abroad are heavy. And when the market rate is below normal, the reverse is true.

Of course there are other causes, and important ones too, but those named are the principal causes of changes in rates under normal trade conditions Eastern capital is extensively used in the West, because the people of the West can make a profit by its use in excess of the interest and dividends sent to its owners. For the very same reason, European capital is extensively used in the United States.

§ 150. Foreign Exchange Rates, 1920.

Normal	Demand Notes	High	Low
4.86	London	4.06¾	3.19
5.18	Paris	10.74	17.15
5.18	Belgium	5.62	17.51
5.18	Switzerland	5.46	6.50
5.18	Italy	13.20	28.81
40.20	Holland	39.00	29.72
19.30	Greece	15.15	9.00
19.30	Spain	19.30	13.18
26.80	Copenhagen	19.15	13.20
26.80	Stockholm	22.15	17.70
26.80	Christiania	20.40	13.15
51.44	Russia	4.70	.75
48.66	Bombay	49.00	28.75
48.66	Calcutta	49.00	28.75
78.00	Hongkong	106.25	69.00
....	Pekin	179.00	99.00
108.32	Shanghai	167.00	91.00
49.82	Kobe	52.50	47.00
49.83	Yokohama	52.50	47.00

50.00—Manila	50.00	46.00
42.44—Buenos Aires	43.75	34.50
33.55—Rio	28.00	16.75
23.83—Germany	3.01	1.01
20.16—Austria	.85	.30
20.26—Jugo Slavia	....	....
20.26—Czecho-Slovakia	....	....
19.30—Belgrade	....	....
19.30—Finland	....	....
19.30—Roumania	....	....

§ 151. **The Fall in Exchange.**—Commenting upon the fall in exchange, the Annalist of Jan. 5, 1920, said: "Never before in the history of finance has the foreign exchange market performed as it did during the last year (1919). Not even in the feverish days of the last week of July, 1914 (just before the outbreak of the European war) was this market so utterly demoralized as it was in the fall of last year, when demand bills on London sold at $3.65¾ to the pound sterling, francs at 11.87 and lire at 13.60 to the dollar. Almost up to the day of their realization such rates were regarded as totally impossible.* * *

"When the year (1919) opened, all of the allied exchanges were still being stabilized under war time provisions. Sterling stood at $4.75¾ for demand; francs at 5.45½ to the dollar, and Italian rates were at 6.36. In the case of the first two, those rates had been established in September 1915, and while francs had fallen from the 'pegged' price during the following year, the market had been brought back to that level when we entered the war, in April, 1917.

From the fall of 1915 to the spring of 1917 the stabilization process was attended to by private banking interests on this side, acting in conjunction with the British and French governments. Italian exchange,

allowed to drift in the early stages of the war, had been taken in hand shortly after our going in by the Italian Exchange institute and the division of foreign exchange of the federal reserve board and was well under control when 1919 opened.

"The pegging arrangement, however, was enormously expensive, and with the signing of the armistice all of the allied governments and the United States Treasury began the consideration of plans for abandoning it. This finally was done in March of last year (1919). On March 18 the French ceased supporting their exchanges, and two days later the British government, through J. P. Morgan & Co., announced they had followed suit. Prior to that, on Jan. 17, a partially unrestricted market had been opened for Belgian francs, but here trading was on a restricted scale, so that there existed no precedent for the broader action and no indication of what was to follow.

"Immediately upon removal of official support, all the exchanges started to fall. Before the end of March sterling was down to \$4.57½; francs to 6.03, equaling the previous low record for the war period, the lire to 7.80, which was well above the former low record. This decline, punctuated by spasmodic rallies, continued until August, when sterling had receded to \$4.12¼, francs had gone to more than eight to the dollar and lire were selling at 9.66, about on a par with the previous low."

(The lowest figures reached in 1919, quoted in the first paragraph of the Annalist article, occurred in the first half of December 1919.)

Note.—The important subject of Foreign Exchange is dealt with in greater detail in Chapters XIII and XIV, for the benefit of those who wish to make a more thorough study of this branch of the banking business.

§ 152. **Exchange Terms.**—There are several terms used in connection with exchange which should be understood. Bankers' bills of exchange are bills drawn by bankers on bankers. Commercial bills are those based upon movements of merchandise, and drawn by merchants. Documentary bills are those which are accompanied by bills of lading. Normal exchange rates are those quoted in newspapers; there are lower or inside rates which are made to brokers, through whom most of the buying and selling is done.

§ 153. **Domestic Exchange.**—The principle of domestic or local exchange is precisely the same as that described as underlying the foreign exchange business. In foreign exchange we have to do with a mixture of dollars and sovereigns, francs, or other foreign money. In domestic exchange we have dollars at both ends of the line.

Suppose A of New York owes B of Chicago $12,000. He buys a draft (banker's check) on Chicago for this sum and mails it to B. Now this draft will cost him something in addition to its face, but it should not cost more than $12 exchange, for the reason that A can take his $12,000 in bills or gold and express it to Chicago for $12. If $12 were charged the rate of exchange would be one-tenth of one per cent.

But suppose that at the same time C of Chicago has $8,000 to send to D of New York and is trying to buy a draft in Chicago. If C keeps his money or turns it over to B, or to B's bank, or for that matter to any bank, A need not ship more than $4,000, for the balance can be turned over to D in New York, or to D's bank, or to any bank. Now $4,000 can be shipped for $4, so that the rate of exchange on a draft for $12,000, only $4,000 of which need be shipped, should not be more than one-thirtieth of one per cent.

Under normal conditions exchange should be based upon the cost of shipping the balances due rather than the gross amounts due. If Chicago is buying more through New York than New York is buying through Chicago, it will be necessary at regular intervals to ship gold or bills from Chicago to New York to meet the differences, and when this is the trade condition, drafts on New York if purchased in Chicago will be at a premium. Drafts bought in New York on Chicago should be at a discount, but as a matter of fact, they will be at par.

There are, of course, many other things which affect exchange. Our banking system is such that the condition of the money market is uniform in each banking center, but these centers may differ very largely from each other, and while in Boston the banks might have more money than they could use, the banks of St. Louis or St. Paul might be unable to meet the demand upon them.

§ 154. **The Cost of Shipping Gold.**—There are times when it is to the advantage of the banker or merchant to ship gold to meet foreign debts. Before the war, if sight bills on England cost more than

\$4.90 it was cheaper to ship gold. The following figures give some particulars of the cost of such shipments: Freight—1/8 of one per cent. Insurance —1/8 of one per cent. Abrasion—From nothing to 1/8 of one per cent on \$20-pieces; 1/8 per cent to 1/4 per cent on \$10-pieces, and 1/4 per cent. to 1/2 per cent on \$5-pieces.

The cost of bringing gold from London to New York is the same as the cost from New York to London. The actual demand for gold in either city will affect its value slightly, and this temporary value must be ascertained before making close figures on a large transaction.

§ 155. **The World's Currencies.**—In addition to the gold and silver coins, the United States has in circulation gold certificates in denominations of not less than \$10, issued upon deposits of gold; silver certificates issued against standard silver dollars deposited in the Treasury; currency certificates issued in denominations of not less than \$5,000 upon the deposit with the Treasury, by national banks, of United States legal tender notes; national bank notes of denominations of \$2 and upward, issued by banks upon the deposit with the Treasury of United States bonds and certificates of indebtedness which are held as security for the ultimate redemption of the notes; United States notes, Federal Reserve notes, and Federal Reserve bank notes.

The currency of Great Britain in actual circulation includes the gold sovereign and half-sovereign; the silver crown, half-crown, shilling, sixpence, and three-pence. The paper money includes the notes of the Bank of England, the smallest denomination of

which is £5, the notes of the Scotch and Irish banks, the smallest denomination of which is £1, and the notes of the joint stock and private banks.

The currency of Canada is in form, at least, similar to that of the United States. Canada has no gold coinage of her own, but the gold coins of the United States and Great Britain pass current and are legal tender. The silver coins are similar to those of the United States, except that there is no silver dollar. The notes issued under the authority of the Dominion are of the denominations $1, 2 and $4, and are redeemable on demand in gold. Bank notes are issued by the chartered banks in denominations not smaller than $5. No special security in the way of deposit of bonds is required, but the notes in case of insolvency are a preferred claim against all the assets of the bank, including the double liability of the stockholders. The aggregate issue rarely exceeds 60 per cent of the paid up capital of the bank and must not exceed one hundred per cent.

The monetary system of Australia is the same as that of Great Britain.

British India has a silver standard unit, the rupee.

There are gold coins in value equal to five, ten, fifteen and twenty rupees respectively. The government issues notes ranging in value from five to ten thousand rupees secured by deposits of gold and silver. The money in circulation in India exceeds one billion dollars.

Germany has the gold standard with the mark as the monetary unit. The smallest gold coin is the

5-mark piece. The silver coins are the 5-mark, 2-mark, 1-mark, ½-mark, and 1/5 mark pieces. The paper money includes treasury notes payable in gold, and the bank notes of the Reichsbank, an institution with individual shareholders, but largely under the control of the government. The issue of notes of less denomination than 100-marks was prohibited prior to the war, since which there have been large issues of paper currency and the mark has greatly depreciated in value.

The Latin Union which includes France, Belgium, Italy, Switzerland, and Greece, has now a single gold standard with the franc as the monetary unit. The smallest gold coin is the 5-franc piece; the silver coins are the franc, the 2-franc, the half-franc and the 20-centimes (one-fifth of a franc). The coins of one country are received at par in the others. France issues bank notes through the bank of France. Belgium issues bank notes through the bank of Belgium, payable to the bearer at sight, and the individuals and the associations are free to issue bank notes on their own responsibility. Italy has no state bank, but there are in the country six banks which are authorized to issue notes payable on demand. The smallest denomination is 50-lire. Switzerland has now a state bank with central offices at Berne and branches throughout the country Greece has three banks authorized to issue notes on such a very low gold and silver reserve that for many years gold has been at a premium.

Spain has the silver peseta, equivalent to the franc, as a monetary unit. It has the same gold and silver coins as the other countries of the Latin Union.

The only bank of issue in the country is the bank of Spain, a private institution, with certain government restrictions. Its smallest note of issue has the value of 25-pesetas.

The Scandinavian Monetary Union embraces Sweden, Norway and Denmark. The krone or crown is the monetary unit. The gold coins are 10-kronen the 20-kronen, and the silver coins are the 2-kronen, the krone, and the fractional currency. Sweden has a bank of issue entirely under the control of the state. Joint-stock banks are also permitted to issue notes under restrictions favorable to the monetary system. Norway has one bank of issue—a joint-stock bank with the state as principal shareholder. Denmark issues notes through a state bank.

The monetary unit of The Netherlands is the guilder or florin. The gold coins are the 10-florin and 5-florin pieces. The bank of the Netherlands, situated in Amsterdam, has the exclusive right to issue notes.

The monetary unit of Russia prior to the revolution was the gold ruble of 100 kopecks.

The gold milreis is the monetary unit of Portugal.

The currency of China is made from an alloy of copper, iron, and tin. In all large transactions, silver by weight is the medium of exchange, the Mexican dollar being used in the South and ingots called shoes, in the North. There are large numbers of private banks which issue notes upon their own authority for local circulation.

The legal money of Japan is the yen of 100 sen.

The yen is almost equal in value to our silver dollar. Trade among Japanese is carried on to a large extent by paper money issued under the authority of the government.

Mexico had a silver standard until 1905, when it adopted the gold standard. The Mexican dollar (el peso) is the unit, and under the name of piaster, is the current coin of several countries in America, Asia and Africa. There are also gold coins in circulation, the smallest (1 peso) being almost equal in value to our gold dollar.

The Central American States have bank notes, but the metallic currency of these republics is largely Mexican.

Chile is on a silver basis, so far as specie is concerned. The real medium of exchange is a depreciated paper currency. The unit is the peso, normally equal to the 5-franc piece of France.

The unit of the Argentine Republic is the same, but of gold. The actual currency is depreciated paper fluctuating greatly in value.

§ 156. **English Money.**—Any person may take bar gold to the extent of £20,000 to the English mint and have it returned to him in sovereigns and half-sovereigns. The Bank of England before the war received bar gold at £3 17s. 9d. per ounce and paid in gold coin. The English sovereign weighs 123.274 grains, and is a legal tender so long as it does not weigh less than 122.5.

English silver and bronze coins are fiat money, that is, their intrinsic value is materially less than

their face value. The difference between their token value and the real or intrinsic value is called seigniorage and this is a large source of revenue.

English gold coins are a legal tender for any amount; silver coins are a legal tender for only forty shillings or less, and bronze coins for one shilling or less. The gold is largely handled by bullion brokers.

The Bank of England notes are very ordinary looking pieces of white paper with plain black printing, somewhat larger in size than those of the United States. The paper is especially made, is very strong, and is not easily burned. No note is paid out a second time. Every check or draft is paid in new bills.

In sending bank notes by mail the Englishman generally cuts them in halves, takes a careful record of their marks and numbers, and sends one of the halves by registered mail, and the other by ordinary post.

The Scotch and Irish banks have a paper issue of their own, and there are joint-stock banks and private stock banks that issue bank notes. These bank notes, although they pass current, are not legal tenders.

§ 157. "Crossed" Checks.—The crossed check so common in Britain is unknown in the United States. It is simply an ordinary check that has upon its face writing or marks which signify that it must be presented through some other bank or banker; and checks of this description will not be cashed

if they reach the bank upon which they are drawn by any other way. They are absolutely worthless for presentation in the hands of the wrong persons.

The banks are forbidden by law to cash such a check over the counter. The receiver of such a check must necessarily deposit it. Our stamped words "Payable only through the ——— clearing house when properly indorsed" have nearly the same effect.

Some houses say on their billheads how checks are to be crossed. When the check is crossed simply by two lines it may reach the bank upon which it is drawn, though any bank; when it is crossed with a bank's name, it must reach the bank upon which it is drawn through the banker whose name appears between the crossed lines. When the drawer knows the name of the payee's banker he usually inserts it; otherwise he simply draws the lines.

English banks do not certify checks. Every check must bear a revenue stamp no matter for how small an amount it is drawn.

§ 158. **The British Consols.**—The British consols are securities representing the consolidated debt of England; the word consol being an abbreviation of consolidated. They are quoted in the financial columns of American newspapers. Here is an illustration: "Consols are unchanged at 94⅝ for cash and 94⅞ for November settlement." The word settlement is used as we would use the word account. On the London Stock Exchange, there are special settling days for securities of all sorts, including transactions in foreign exchange. By "November

settlement" it is understood that the consols are to be paid for on the November settling day.

§ 159. **Canadian Money.**—Many Americans hesitate to accept Canadian money, usually for the reason that they have difficulty in passing it and partly from ignorance of its security. The Canadian silver coins are in reality of greater intrinsic value than the corresponding coins of the United States, for the reason that they contain more silver.

The Canadian one-dollar bill, two-dollar-bill, and four-dollar-bill are equal in value to the very best security offered in the United States, for the reason that they are issued by the Canadian government and are covered by actual gold and silver in the treasury. The exchange value of the Canadian dollar, however, depreciated somewhat after the World War.

The notes issued by the Canadian banks are almost equally good.

The Bank of Montreal is one of the largest and strongest financial institutions in the world. It has about 200 branches in the large cities and towns of the Dominion. The Canadian Bank of Commerce and the Merchants' Bank of Canada are also institutions of splendid strength.

No bank is chartered in Canada that has not a capital of at least $500,000. There are in all about fifty banks with numerous branches. These banks issue notes of denominations of $5 and upward, but the government regulations are so exacting that if a bank should fail the holders of its notes would be

almost sure to receive their full value. These banks always pay out over the counter their own bills.

Under the former United States system, which left each bank so largely dependent upon the fortunes of its locality, and the business of each locality so entirely dependent upon its local banks, it was not unusual to see mutual ruin of banks and business in numerous widely scattered localities, while the business of the country as a whole was sound. Such results are impossible in Canada. The widely extended system of each of the great banks, with its branches in every part of the country, constitutes a sort of financial insurance, by which each helps to guarantee the soundness of all; while the Canadian branch systems, interlocking at every town, leave it simply impossible that any local point of the least importance should for a moment be lacking in the most complete discount, currency, and other banking facilities, so long as the whole business of the Dominion is not involved in common ruin. The currency system is elastic and always meets the demands. Panics for fear of stringency are unknown. A run on a bank, as it is understood in the United States, is practically impossible.

§ 160. **Letters of Credit.**—The ordinary letter of credit is the leading and usual instrument for the use of travelers in Europe and has now become such a common feature of banking that every one should be familiar with its form and purpose. The first page of a letter of credit is the credit proper, authorizing the various correspondents of the bank issuing it, who are named on the third and fourth pages, or any other banker to

whom the letter may be presented, to pay the holder, whose signature is given on its face, money to the extent of the amount named. The second page shows how the holder avails himself of the advantages of the letter. It gives the names of the banks to which he presented his letter and the amount paid by each. With such a letter a traveler can make a trip around the world and not carry in his pocket at any one time more gold or silver or bills than would be necessary to meet immediate local expenses.

When a banker issues a letter of credit, the person purchasing it, and who is to use it abroad, places his signature upon a lower corner of the document in the banker's presence. Other copies of the signature are left and are forwarded to the leading foreign bankers drawn upon. When the person buying the draft presents himself at a London or Paris bank with his letter of credit and asks for a payment upon it, the banker asks him to sign a draft on the American banker issuing the letter, for the amount required, which amount is properly entered upon the letter of credit before it is returned to the payee. Payment is usually made upon the simple identification or comparison of signatures.

If a traveler should lose his letter of credit he should notify at once the banks upon and by whom it is drawn.

These letters are cash anywhere. Almost any banker in the world will at any time consider it to his advantage to buy a reliable dollar draft on New York. Such drafts should sell at a premium anywhere.

Questions for Review, Chapter VI.

1. What is the function of credit in modern business?
2. How large a portion of the business of the world is done on a credit basis?
3. Name a modern instance of contract credit obligations being exchanged without giving evidence of the debt.
4. What is the origin of the credit instruments which have developed into bills of exchange?
5. When were such bills first used, and in what form?
6. What is meant in commerce by the term "exchange"?
7. Give an illustration of the convenience of exchange.
8. What is meant by the "par of the currency" of any two countries?
9. What is the par of exchange between Great Britain and United States?
10. What do we mean when we say that exchange is "in favor of" London or Paris?
11. What causes fluctuations in the price of gold?
12. Why are the imports and exports of bullion the real test of exchange between two countries?
13. Under what conditions is it advantageous to a New York merchant to pay a debt in London by sending the actual coin across?
14. How was exchange with European countries affected by the World War?
15. To what extent is the rate of exchange affected by the balance of trade?
16. Name some other conditions that affect the rate of foreign exchange.
17. In what respects does the principle of domestic exchange differ from that of foreign exchange?
18. Upon what should the rate of domestic exchange be based under normal conditions?
19. When is it cheaper to ship gold to England than to buy sight bills?
20. What facts tended to make the city of London the financial center of the world?
21. What is the nature of a "crossed" check?
22. What advantages are enjoyed under the Canadian banking system?
23. What is the nature of a letter of credit?
24. How does a traveler obtain money abroad upon a letter of credit?

CHAPTER VII

Bank Credits

Section 161. Facts Required from Borrowers.—"The average statement required by a city bank makes a borrower dig down to the blunt reality. He may have been deluding himself, but if he answers the questions honestly he often finds he must discount his former estimates heavily. Whether it is your form of organization and total of bills receivable, or the time you arrive at the office and the church you attend—every fact counts with the bank. The answer to what it wants to know is—everything."

§ 162. The Subject of Credit.—In the year 1892 there were not more than a half-dozen credit departments in as many banks in the United States, and during the entire period of the existence of the American Bankers' Association, from 1875 until that date, the subject of "Bank Credits" had never been discussed in a practical way by its members. Since that time, however, the subject has come up for discussion before many State bankers' associations throughout the country, and the introduction of credit departments in banks has become very general.

On February 9, 1895, the executive committee of the New York State Bankers' Association adopted resolutions recommending to its members "that they

request borrowers of money from their respective institutions to give them written statements over their signatures of their assets and liabilities, in such form as the committee on uniform statements of the various groups might recommend." Acting upon these resolutions, nearly all of the groups of the New York State Bankers' Association adopted uniform statement blanks, and the example set by that association has been followed by many associations in other states.

In 1898, the National Association of Credit Men, a large and powerful organization of nearly 3,000 members, after a year's investigation of the subject, adopted uniform statement blanks which have ever since been widely employed.

§ 163. **Uniform Statement Blank.**—On September 7, 1899, the American Bankers' Association, in convention assembled at Cleveland, Ohio, adopted a uniform property statement blank, to be supplied to its members and thus placed the stamp of its approval upon the credit department for banks, at the same time instructing its secretary to set up in his office a model department, and to furnish information to its members regarding the work of the same.

These efforts were practically the beginning of credit research, and as we trace the subject during the past following years and note the growth of these methods and the many difficulties which have been overcome, we certainly feel that something has been gained by the agitation and discussion of bank credits, and much good has been accomplished.

§ 164. **Laws Governing Credit.**—In an address in June, 1896, at the organization of the National Association of Credit Men, James G. Cannon, of the Fourth National Bank, New York City, said: "Credit can hardly be classed among the sciences, and certainly it cannot be said to be an exact science, because it is not governed by any definite, fixed laws." But years of study proved to the satisfaction of this great banker and others that there are certain definite, fixed laws governing credit, that there is, in fact, a credit science, and some of its principles, its mechanism, and its guiding rules may now be stated, in language subsequently employed by Mr. Cannon.

§ 165. **Change of Methods.**—It is evident to students of financial affairs that there has been a gradual change of method in the buying and selling of commercial paper from that which obtained in former times. Borrowers no longer confine themselves to one place, but go where funds can be produced to the greatest advantage. Merchants in the smaller towns go away from home to borrow money, and bankers in smaller cities go away from home to procure investments. Often bankers do not feel that they can break the rate locally, but it frequently happens that they will send to the large money centers and buy the paper of their home merchants at a lower rate than they would feel that they could take the note for direct. One-eighth per cent will take many a business man from home for his accommodation. The practice is growing for the banks in larger cities to buy commercial paper for their correspondents and in the face of these changes in methods it becomes more and more imperative for

bankers who handle commercial paper, and who are located in the large money centers, to be fully informed in the widest measure upon the credit of borrowers.

§ 166. **Statements from Borrowers.**—The cornerstone of credit science may be said to be the requiring from borrowers of statements of the conditions of their affairs. This has now become an accepted custom in the relation between banks and borrowers on commercial paper. It has come to be recognized that the practice is of value to both the bank and the borrower, and this may be considered the reason for its success. Furthermore, the making of statements oftentimes renders concerns themselves aware of weaknesses in their methods of operation, financial practices and results of business. The banker, having a substantial interest in the success of the borrower, may frequently give wholesome advice or timely warning from his wide experience in commercial affairs and his foresight in monetary matters.

There is a distinct parallel in the results that have worked out from the practice of giving statements, to the results with which bankers are familiar in the methods of the national banking system. Here statements of conditions and bank examinations have resulted in wise improvement in methods, in wholesome safeguarding of funds, in conservative financing, and in general advantage.

Again, there is a parallel in the results which have developed from the mutual relations of manufacturers and the factory mutual insurance companies. Here the companies called for improvements

in buildings and equipment, which have rendered fire a remote contingency. Whoever doubts the joint interest of such a movement has never experienced the paralyzing effect which a fire has upon the affairs of any concern. The statement of condition has come to stay, and is fundamental in credit matters.

§ 167. **The Credit Department.**—But if the statement is the foundation of the credit structure, the credit department may be considered to be the superstructure. This division of the bank's operating mechanism may be said to be the clearing-house for credit information, the headquarters for credit analysis, the storehouse of facts relating to those who are commercial borrowers of the bank's money. The credit men are the watchdogs of the bank's risks and the guardians of the investments made for its correspondents. The department must be manned by its most faithful, reliable, intelligent, tactful men, who must be capable of infinite pains, of inexhaustible patience, and of absolute loyalty. Their eyes and ears must be open to every contingency that no sign may go unheeded. They are compelled to walk in the ruts of routine and yet be pathfinders constantly. No man who works mechanically will develop into a successful credit man.

The credit department should have an equipment commensurate with its importance. It should be the inner chamber in all respects. Recorded confidences should never be violated, and there should be no latchstring to this department. Its mechanism of blanks, files, vaults, and office fixtures should be perfectly adapted to its service, and every means

which ingenuity can devise should be utilized to assist its work.

§ 168. Analysis of Statements.—In our review of the credit science of to-day we have noted the universal custom of giving statements. We have glanced over the mechanism provided for the handling of these statements and correlated data, but the important feature of all credit science is: What is the banker's interpretation of these statements? It is clear that a statement which is not submitted to analysis is a menace; because, first, if errors have been made, if lack of judgment on the part of the management of the concern has been shown which is not brought to the attention of the borrower; if reckless methods have been indulged in or any dishonesty has been practiced, the very fact that a statement has been received and accepted by a banker either lulls into a sense of security the careless or heedless borrower, confirms the reckless financial habit, or establishes the dishonesty if such exists. An unanalyzed statement is therefore worse than no statement at all.

Frank and open statements, bearing upon their face the evidence of a true condition of affairs, are the greatest factors in establishing credit. Nothing will more firmly cement the union between borrower and banker than such a statement, and nothing will be of more value to a banker and of less harm to an honest, enterprising borrower. Hidden facts are revealed by analysis and skill in reading between the lines is an important part of the credit man's training. By this means weaknesses may frequently be

discovered and proper steps taken to avert trouble before acute difficulty arises.

§ 169. Principles and Rules of Credit Science.—Let us summarize, then, the principles and rules of the credit science of to-day.

Its principles are: (1) To reduce losses. (2) To eliminate disproportionate risks. (3) To conserve worthy interests. (4) To war on dishonesty and incompetence.

Its mechanism includes: (1) The statement of condition, showing assets and liabilities, annual business, net results of business, and commercial expenses. (2) The credit department.

Its guiding rules in the present state of bank credits are the following:

Rule No. 1. Quick assets only are a basis for loans.

Rule No. 2. Fixed assets only considered as giving an unknown support to the quick assets.

Rule No. 3. The debt limit of the borrower has been exceeded when his liabilities exceed 50 per cent of his quick assets (the so-called 50 per cent credit rule).

§ 170. Accuracy is Required.—Let us turn to the next step in the development of credit science. At the outset we remarked that there was a growing requirement that bankers in large money centers should be expert in credit matters; it is necessary, therefore, that the means or mechanism by which they are to inform themselves should be kept fully abreast of the times. The next step in the develop-

ment of credit science therefore lies in the direction of accuracy. The trend of every science is toward exactness. The advance to this point justifies a further step in advance. Low rates of interest on loans make losses intolerable. General prosperity and other conditions limit the field for commercial loans at paying rates and require bankers carefully to safeguard any extension of the field of loans by exact and accurate credit tests.

This next step may be taken by establishing the custom of requiring statements of financial condition to bear joint certificates of a certified public accountant and of an engineer:

(a) As to the valuation of cash assets.
(b) As to valuation of merchandise assets.
(c) As to valuation of plant assets.
(d) As to liabilities.
(e) As to net worth.
(f) As to gross business.
(g) As to past results of business.
(h) As to future prospects.

§ 171. Value of the Accountant.—The certified public accountant has come into prominence within the last few years and his profession has the guarantee of law in most states of the Union. He concerns himself with the books of account, and records and statements prepared by him have the support of such books, and the banker has the sense of security due to the disinterested and impartial nature of the accountant's position. He may be called the referee in accountancy and the expert on cash valuations.

§ 172. **Value of the Engineer.**—The engineer deals with physical matters. His valuation on merchandise is essential in determining quick assets. He concerns himself with the valuation of the fixed assets and the adaptability of the plant to the purposes for which it is being used. His analysis of all correlated questions respecting raw supplies, vulnerability to competition, price fluctuations, trade, and similar conditions is essential to a right interpretation of statements of concerns affected by such questions.

§ 173. **Inaccurate and Dishonest Statements.**—This radical step is made necessary because inaccurate and dishonest statements are constantly received by bankers. Many statements reach them which are made by irresponsible parties—clerks and undermen—and the management is frequently in ignorance of true conditions. Protection against such is essential.

§ 174. **All Benefited by Examination.**—All are benefited by the examination of their assets. The interpretation of credit statements is a technical operation, and the statements prepared by trustworthy professional men are generally more reliable than those not so prepared. The hard and fast 50 per cent credit rule long observed by bankers has failed, and an exact and accurate study of each individual concern now takes its place, each concern being entitled to credit on its merits. Working on imperfect information and applying one credit rule resulted necessarily in a destructive policy. Accuracy enables the banks to follow a constructive policy,

which is more nearly in accord with their position in the business world.

When statements are subjected to searching analysis, certified public accountants and engineers, then credit is extended strictly on the merit of the individual applying for loans.

§ 175. **Practical Features of Bank Credits.**—We may now consider some practical features of the business based on bank credits, such as the relative volume of bank loans on commercial paper to the various classes of borrowers. While this relation undoubtedly fluctuates widely, the following statement reflects about the average condition:

	Per cent
Commercial loans by bankers to retailers	50
Commercial loans by banks to commission men	15
Commercial loans by banks to jobbers	30
Commercial loans by bankers to retailers	05
	100

This was ascertained from the distribution of 186 different loans, aggregating upward of thirteen million dollars. The average distribution of some sixty million dollars of loans placed through brokers in New York gave the following relative proportions:

	Per cent
Commercial loans through brokers to maanufacturers	45
Commercial loans through brokers to commission men	15
Commercial loans through brokers to jobbers	30
Commercial loans through brokers to retailers	10
	100

The striking preponderance of loans from banks to manufacturers is evident from both of these statements. It becomes of interest, then, to study further these various classes of borrowers, and from the statements of about one hundred concerns a set of typical balance sheets has been prepared that will be of profit to the reader to study with care.

§ 176. Typical Balance Sheet for Manufacturers.

Number of concerns averaged 62

		Per cent
Quick assets	$1,000,000	44
Fixed assets	1,270,000	56
Total assets	$2,270,000	100
Liabilities	610,000	27
Net worth	$1,660,000	73

Liabilities 61 per cent of quick assets.

Gross sales per $1 quick assets $3.30
for 44 concerns.

Gross sales per $1 total assets 1.60
for 44 concerns.

§ 177. Typical Balance Sheet for Commission Men.

Number of concerns averaged 7

		Per cent
Quick assets	$1,000,000	95
Fixed assets	50,000	5
Total assets	$1,050,000	100
Liabilities	520,000	50
Net worth	$ 530,000	50

Liabilities 52 per cent of quick assets.

Gross sales per $1 quick assets........................$3.60

Gross sales per $1 total assets........................ 3.45

§ 178. Typical Balance Sheet for Jobbers.

Number of concerns averaged........................28

		Per cent
Quick assets	$1,000,000	90
Fixed assets	110,000	10
Total assets	$1,110,000	100
Liabilities	440,000	40
Net worth	$ 670,000	60

Liabilities 44 per cent of quick assets.

Gross sales per $1 quick assets........................$2.25
on 25 concerns.

Gross sales per $1 total assets........................ 2.08
on 25 concerns.

§ 179. Typical Balance Sheet for Retailers.

Number of concerns averaged 6

		Per cent
Quick assets	$1,000,000	75
Fixed assets	330,000	25
Total assets	$1,330,000	100
Liabilities	480,000	36
Net worth	$ 850,000	64

Liabilities 48 per cent of quick assets.

Gross sales per $1 quick assets........................$2.33
on 5 concerns.

Gross sales per $1 total assets........................ 1.82
on 5 concerns.

§ 180. Proportion of Quick Assets.—The exactness of these relations is not important for our study of the principles involved in credit research. Suffice it to say that a study of the several balance sheets will disclose interesting comparisons. It is instruc-

tive to note in these balance sheets the relative proportion of quick to total assets:

	Per cent
Manufacturers have quick assets of total assets	44
Commission men have quick assets of total assets	95
Jobbers have quick assets of total assets	90
Retailers have quick assets of total assets	75

What stronger argument could there be for accuracy in credit methods than that manufacturers, who borrow one-half the money loaned on commercial paper, have 56 per cent of their assets in such form that banks may reject them as unknown and unknowable on account of imperfect information and inability to determine their value?

§ 181. **Net Worth of Borrowers.**—Again, referring to these balance sheets, let us compare the net worth of these classes of borrowers:

Manufacturers show net worth 73 per cent of their assets.

Commission men show net worth 50 per cent of their assets.

Jobbers show net worth 60 per cent of their assets.

Retailers show net worth 64 per cent of their assets.

From the face of this statement the manufacturer maintains an eminently satisfactory margin behind his loans, and what bankers want to know is that this claimed margin is conservatively valued.

§ 182. **Assets and Sales.**—Let us now examine into the gross sales which tell the tale of the entire

managerial activity, the mobility of the quick or working capital:

Manufacturers, gross sales per $1 quick assets	$3.30
Commission men, gross sales per $1 quick assets	3.60
Jobbers, gross sales per $1 quick assets	2.25
Retailers, gross sales per $1 quick assets	2.33

Here we are face to face with the most telling factor against a hard-and-fast credit test, in that the wide difference in results in the various lines of business are brought out. How can a uniform credit test be applied to such widely varying lines of business?

Of equal importance in showing the variations in different lines of commercial enterprise are the figures comparing the gross business done per $1 of total assets, representing as it does the total investment in plant and working capital:

Manufacturers, gross sales per $1 total assets....	$1.60
Commission men, gross sales per $1 total assets..	3.45
Jobbers, gross sales per $1 total assets..............	2.03
Retailers, gross sales per $1 total assets............	1.82

§ 183. **Failure of Uniform Credit Tests.**—Becoming more specific in our inquiry we may also come to the conclusion that if a uniform credit test fails, when applied to various lines of business, such as manufacturing, jobbing, etc., it will also fail when applied to various branches of the same line of business.

The following figures taken from the twelfth census of the United States will illustrate the wide variations among manufacturing interests. The census report, covering the various branches of the

manufacturing division of commercial affairs showed a proportion of working capital to total capital as follows:

	No. of Concerns	Per cent of Working Capital to Total Capital
Food products	61,302	46
Textiles	30,048	54
Iron and Steel	13,896	50
Lumber	47,079	45
Leather	16,989	72
Paper and Printing	26,747	40
Liquors	7,861	41
Chemicals	5,444	51
Clay, glass, etc.	14,809	37
Metals	16,305	52
Tobacco	15,252	76
Vehicles for land transportation	10,113	53
Shipbuilding	1,116	45

There will be noted a fluctuation from 37 per cent to 76 per cent, while all these industries averaged 48.8 per cent, these variations emphasizing the futility of uniform credit tests.

The census report also gave some interesting facts regarding the fluctuation in the gross business per $1 working capital and $1 total capital as shown below:

	No. of Concerns	Gross Business per $1 of Working Capital	Gross Business per $1 of Total Capital
Food products	61,302	$5.22	$2.42
Textiles	30,048	2.24	1.20
Iron and steel	13,896	2.33	1.17
Lumber	47,070	2.40	1.09
Leather	16,989	2.35	1.17
Paper and printing	26,747	2.70	1.09
Liquors	7,861	1.96	.79
Chemicals	5,444	2.17	1.11
Clay, glass, etc.	14,809	2.28	.83
Metals	16,305	3.52	1.83
Tobacco	15,252	3.02	2.28
Vehicles for land transptn.	10,113	2.42	1.21
Shipbuilding	1,116	2.14	.97
Average		$2.70	$1.32

Observing this it will be noted that the gross business per $1 of working capital varied from $1.96 to $5.22. The gross business per $1 of total capital varied from 79 cents to $2.42. This further emphasizes the fact that lines of business should be judged strictly on their individual merits, rather than by hard and fast rules.

It would be interesting, if space permitted, to compare many of the branches of these industries which vary even more widely than the grand division of manufacturers. Every consideration seems to impress the fact that one of the cardinal and fundamental principles of credit science must be accuracy in all the term implies. This forces us to the conclusion that the old 50 per cent credit rule as regards quick assets to liabilities should not be the chief factor in fixing upon the responsibility of borrowers in the light of the variation among the various classes enumerated. The time is coming when all bankers will be compelled to secure information which is accurate and reliable, and which has behind it the weight of certification and proof.

§ 184. To Encourage Manufacturers.—Bankers naturally look forward to extending commercial loans at paying rates of interest. Inasmuch as loans which are secured by assets not readily convertible into cash are those which are subject to higher rates, the field of the manufacturers, now representing fully one-half of the loans direct from banks, is entitled to the most careful consideration in the study of bank credits, and is of such importance as to demand intelligent examination and scientific treatment.

The manufacturers of the United States, numbering upwards of 500,000 concerns, have a gross product of $25,000,000,000 requiring an investment in plant and working capital of $23,000,000,000—a volume of business and extent of investment which is stupendous in the extreme. The manufacturer is essentially the prime mover of commerce, and has to carry a large investment in plant and machinery. Invention and improvement of machinery and products are continuous, thus making large inroads into his sinking fund for renewals and scrapped machinery. He must maintain large stocks of raw material and be secure in the continuity of his supplies. He must carry large values of goods in process. He must risk the fluctuations in the cost of raw materials and sales value of his finished goods. He must take chances on changes in style and be at the mercy of the caprice of fashion. All of these considerations should lead banks to count upon the manufacturer as substantial, conservative, keen after business, acute for economies; and the exent of his investment should give him such an intense personal interest in his enterprise that banks should expect to find him the most promising of their applicants for loans. But to handle this business safely and wisely demands accuracy in credit methods.

§ 185. Importance of Credit Science.—Credit science now occupies a prominent place in commercial affairs. The requirement of credit is a proper and necessary condition of business, and the usefulness of credit is firmly established. Every consideration demands of the banks that as this science develops it shall be firmly established in all respects

upon substantial principles, and that as its rules and customs are unfolded from time to time they shall serve to strengthen jointly the bank in extending credit and the borrower in taking advantage of the credit.

It requires joint and harmonious action on the part of all interested in bank credits to accomplish the forward step which has been outlined in this chapter; but where this is accomplished, judging from banking experience in the past, the results are of surpassing value to the entire commercial community.

Let us restate, then, the principal facts regarding this advance step, which is recommended in principle to all banks and has already been taken by many of them:

(1.) It shall be in the direction of accuracy.

(2.) Statements of condition shall be required of borrowers, bearing the certificate of certified public accountants and of engineers, (as competent judges of assets).

(3.) Statements of condition shall be invariably analyzed faithfully and accurately, and with all the thoroughness, weight of experience, and knowledge which can be brought to bear upon them by best organization and equipment.

Questions for Review, Chapter VII.

1. When did the introduction of credit departments in banks become general?

2. When did the American Banker's Association adopt a uniform property statement blank for the use of borrowers?

3. When did the National Association of Credit Men adopt uniform statement blanks?

4. What are the basic principles of credit science as it is now understood?

5. Why is it now more imperatively necessary than ever for bankers to be fully informed upon the credit of borrowers?

6. Is a proper "statement of condition" of any value to the borrower as well as to the bank, and why?

7. What are the requirements of a modern bank credit department?

8. Why is it necessary that a statement of condition should be submitted to analysis?

9. Give a summary of the mechanism and rules of credit science.

10. What is the nature of the so-called "50 per cent. credit rule"?

11. How do certified public accountants and engineers assist the credit department?

12. About what percentage of commercial loans are made by banks to manufacturers? to commission men? to retailers?

13. What distinction is made by banks between "quick" assets and "fixed" assets?

14. What is the average proportion of quick assets to total assets of manufacturers? of commission men? of retailers?

CHAPTER VIII

The Clearing House.

Section 186. An Essential System.—In large cities checks representing millions of dollars are deposited in the banks every day. The separate collection of these would be almost impossible, were it not for the clearing-house system.

Each large city has its clearing-house. It is an establishment formed by the banks themselves, and for their own convenience. The leading banks of a city connect themselves with the clearing-house of that city and through other banks with the clearing-houses of other cities, particularly New York. Country banks connect themselves with one or more clearing-house through city banks which do their business for them. The New York banks, largely through private bankers, branches of foreign banking houses, connect themselves with London. So that each bank in the world is connected indirectly with every other bank in the world, and in London is the final clearing-house of the world. The daily clearings in New York in a recent year averaged \$326,505,468 (for 51 banks) and the average daily balances paid in money amounted to \$13,797,644.

Usually once a week the banks of a city make to their clearing-house a report based on daily balances, of their condition.

§ 187. **Check Collections.**—Each bank in a city receives on deposit, daily, checks on other banks. Instead of sending these by messenger to the other banks they are sent to the clearing-house at a fixed hour each day—in some cities twice a day.

The banks of a clearing-house city are numbered. These numbers are seen stamped upon checks which the bank handles in the process of collection. Bank A may for instance carry checks amounting to $200,000 to the clearing-house for collection. Banks C, D, E and F may have checks on A amounting to $189,240, which they send to the clearing-house for collection. This would show a balance of $10,760 in A's favor, which is paid to bank A by the clearing-house in clearing-house certificates or due bills. If the balance were against A, the amount due would have to be made up within the hour limit fixed by the clearing-house regulations.

Suppose, for illustration that Brown of Lynn owes Smith of Media $25, and pays the amount by a check on a Lynn bank. This check will go by mail from Lynn to Media. Smith will deposit it in a Media bank. The Media bank will send it with other checks to its Philadelphia correspondent, say the Penn National. The Penn National will send it with other checks to its New York correspondent, say the Chemical National. The Chemical will forward it with other checks to its Boston correspondent, say the First National. Now the First National of Boston may not be the Boston correspondent of the Lynn bank. It therefore sends the check for collection through the Boston clearing-house to the bank which does the Boston business for the particular Lynn

bank upon which the check is drawn, say the Second National. The Second National sends the check to Lynn, where it is charged up against Brown's account. This system of collections is almost as perfect as is the post-office system of carrying registered mail.

§ 188. **The Wanderings of Checks.**—Under old-fashioned methods, each bank was in the habit of selecting its collection agents, sending them by mail their collection paper, charging their customers very substantial collection rates and passing the same to their credit when collected. Nowadays the country trader, no matter where he is located, sends his check on a local bank to pay his account in a distant city, and the receiver of the check expects his bank to collect the amount of the check free of expense, and to give him full credit for it the day it is deposited.

Suppose for instance that a merchant of Selma, Ala., sends his check on a Selma bank by mail to pay a bill in Alpena, Mich. The Alpena merchant deposits it in his local bank, and this local bank sends it to its Detroit correspondent; that is, deposits it in the Detroit bank where its account is kept. The Detroit bank sends the check to its Chicago correspondent. The Chicago bank may have no connection with a Southern city. It sends the check to its New York correspondent. The New York bank forwards the check to New Orleans, where it may pass through the clearing-house to some other New Orleans bank which forwards it to its correspondent in Mobile. The Mobile bank sends the check to Selma, and has

it charged up to the account of the man who issued it.

Now all these banks and clearing-houses through which the check passes, stamp their indorsement and other information on the back of the check, so that the check itself bears a complete record of its travels.

Millions of dollars are collected by banks daily in this way, and generally without expense to their customers. It is estimated that these collections cost the New York city banks more than two million dollars a year in loss of interest while the checks are en route. Fifteen thousand collection letters are sent out every day by the banks of New York City alone. There have been spasmodic attempts in some cities to make a charge for the collection of out-of-town checks, but such attempts are unpopular among business men.

§ 189. General Rules.—The following selections from the general rules of a large clearing-house will give the reader some idea of the exacting character of clearing-house regulations:

"Errors in the exchanges and claims arising from the return of checks or other cause are to be adjusted directly between the banks which are parties therein, and not through the clearing-house.

"Whenever checks which are not good are sent through the clearing-house they shall be returned by the banks receiving the same to the banks from which they were received as soon as it shall be found that said checks are not good; and in no case shall they be retained after one o'clock.

"The manager shall immediately report to the clearing-house committee any apparent irregularity in the dealings of any bank belonging to the association that comes to his notice, and receive the instructions of the committee in regard thereto.

"The committee shall have power to remove the manager or any of the clerks, whenever, in their opinion, the interests of the association shall require it.

"The hour for making the exchanges at the clearing-house shall be ten o'clock A. M. each day. At a quarter past twelve o'clock, noon, the debtor banks shall pay to the manager, at the clearing-house, the balances due from them respectively either in coin or in such other currency as the laws of the United States shall require, or in such certificates as shall be authorized by the clearing-house association, excepting sums less than one thousand dollars, which may be paid in bills of the debtor bank.

"At half-past one o'clock P. M. the creditor banks shall receive from the manager, at the same place the balances due to them respectively; provided all the balances due from the debtor banks shall then have been paid to him.

"Should any bank fail to pay the balance due from it at the proper hour the amount of such balance shall be immediately furnished to the clearing-house by the several other banks in proportion to their respective balances against the defaulting bank resulting from the exchanges of that day."

§ 190. **Clearing-house Clerks.**—The bank clerks

who attend to the clearing-house business must be experts in their special work. The slightest error on the part of one clerk may prolong indefinitely the entire settlement. As a check against error very severe rules and penalties are established. The following are samples from the by-laws of the same clearing-house whose general rules are quoted above:

"1. For disorderly conduct of any clerk, or other officer, at the clearing-house, or disregard of the manager's rules and instructions, for each offense, fine $4.00.

"2. For any officer failing to attend punctually at the hour for making the exchanges, $4.00.

"3. Debtor banks, failing to appear to pay their balances before a quarter past 12 o'clock, $3.00.

"4. Any error in the credit ticket (that is the amount brought), $2.00.

"5. Errors in making the balance ticket (that is, the amount received) entries, $2.00.

"6. Failing to deliver check tickets before half-past ten o'clock, $1.00.

"7. All other errors, $2.00.

"Any clerk, or other officer, who shall repeatedly and perseveringly disobey the orders or instructions of the manager, shall, with the approbation of the clearing-house committee, be expelled, and not re-admitted without the written consent of the committee. Thirty minutes will be allowed for the morning business settlement, and for each additional fifteen

minutes' detention, $2 will be added to the fine under No. 3."

§ 191. **Foreign Clearing-Houses.**—England has three bank clearing-houses and France one. The clearing principle is used in England to adjust the complicated accounts of the through traffic of connecting railroads, and to simplify the fortnightly deliveries of stock on the London Stock Exchange. Every clearing-house bank in London, and the clearing-house itself, keeps accounts with the Bank of England, and differences are settled by transfers from one account to another.

London originated the clearing-house. It was formed spontaneously by the clerks of the London private bankers, who, to save themselves the trouble of going about to each bank, got into the habit of meeting in a central room to settle their mutual claims. A similar practice arose among French merchants, in old times, of making their bills payable at the great annual fair in Lyons, where they met to balance their debts, and pay the differences.

If gold were to be used instead of the clearing-house machinery in either New York or London, the weight to be moved every day long distances would exceed 200 tons. The clearing-house establishes a fellowship among banks that has already proved, in times of financial panics, of the greatest service to themselves and the community, while the value of its daily service to the public is incalculable.

Questions for Review, Chapter VIII.

1. What is the object of the modern clearing-house system?

2. Where do we find the final clearing-house of the world?

3. What is the daily amount of the bank clearings in New York City?

4. Sketch briefly the daily operations of a clearing-house in a large city.

5. What kind of rules are established by clearing-houses to prevent errors?

6. Where did the clearing-house idea originate?

7. For what other purposes besides banking is the clearing-house principle used in England?

8. How are the banks of a city identified on checks which each bank handles for collection?

9. How are the balances of the banks in a city settled at the clearing house?

10. How often are checks sent to the clearing house by member banks?

11. What charge is made by banks for the collection of out-of-town checks, and is it the rule to make such a charge?

12. What special qualification is required in a clearing-house clerk?

CHAPTER IX

The Federal Reserve System

Section 192. Need of Government Control.—On June 23, 1913, President Wilson personally appeared before Congress and called public attention to the deficiencies in the existing system of banking and currency in the United States, at the same time urging prompt remedial legislation by the adoption of a bill providing for the establishment of a system of Federal Reserve Banks, designed "to give the business men of this country a banking and currency system by means of which they can make use of the freedom of enterprise and of individual initiative."

"We must have a currency," said the President, "not rigid as now, but readily, elastically responsive to sound credit, the expanding and contracting credits of everyday transactions, the normal ebb and flow of personal and corporate dealings. Our banking laws must mobilize reserves; must not permit the concentration anywhere in a few hands of the monetary resources of the country or their use for speculative purposes in such volume as to hinder or impede or stand in the way of other more legitimate, more fruitful uses. And the control of the system of banking and of issue which our new laws are to

set up, must be public, not private, must be vested in the Government itself, so that the banks may be the instruments, not the masters, of business and of individual enterprise and initiative."

§ 193. **Twelve Reserve Districts.**—Congress took prompt action, following this message, and the Federal Reserve Bank Act became the law of the land by the signature of the President, on December 23, 1913. It provided for the establishment of not less than eight and not more than twelve Federal Reserve Banks, and on November 16, 1914, twelve such banks were accordingly established and began operation in the following cities, which had been selected as the Reserve cities for the twelve Reserve Districts established under the law:

District No. 1, Boston, Mass.; No. 2, New York, N. Y.; No 3, Philadelphia, Pa.; No. 4, Cleveland, O.; No. 5, Richmond, Va.; No. 6, Atlanta, Ga.; No. 7, Chicago, Ill.; No. 8, St. Louis, Mo.; No. 9, Minneapolis, Minn.; No. 10, Kansas City, Mo.; No. 11, Dallas, Texas; No. 12, San Francisco, Cal.

§ 194. **A New Epoch in Banking.**—With the adoption of the Federal Reserve Act, there was a general feeling that American business and banking had entered upon a new epoch. Many bankers throughout the country hastened to apply for membership in the respective Federal Reserve Districts and the sentiment among the banks was typically expressed by the directors of the National Copper Bank, who said: "As we watched the development of the Act in Congressional debate, we became impressed with the advantages to be gained through

its operation, and our later and more careful study has only strengthened our earlier impressions.

"The great essentials—reserves, circulation, discounts, acceptances, refunding of bonds, foreign branches, farm loans, clearing of transit items—are well provided for, but with a wisdom which recognizes the dangers of sudden change, and allows years in which to perfect the transferring of banking operations from the old course to the new. It is true there is great power centered at Washington, but the country's past experience with the Treasury Department has been such as to warrant confidence in the future policies of the Federal Reserve Board—the central controlling body established by the new Act.

"Doubtless there will be alterations in the Act from time to time, as experience points out better methods here and there, but in the main we believe the Act will stand the test, and marks the longest step forward that American business has taken in many a day."

The belief is, in fact, general that the United States has now the best arrangement in its history for making the banking system responsive to the needs of trade and the monetary system elastic enough to prevent the recurrence of the once-dreaded panics, such as those of 1893 and 1907. The value of the Federal Reserve System was apparent during the World War period and the reconstruction period which followed, when it proved fully equal to all demands made upon it and aided greatly in maintaining the stability of the banks and their value to the community in times of stress and emergency.

During the first twelve months of our country's participation in the war the reserve system became established upon a basis of confidence and respect, even in fact of admiration, among both bankers and business men; and its future therefore seems assured so long as good management deserves the support now enjoyed.

§ 195. **Main Features of the Act.**—Under this system the United States, as already indicated, is divided into twelve Federal Reserve Districts, each having a regional Federal Reserve Bank with a capital of at least $4,000,000 subscribed by the member banks of the district. National banks are obliged to become members, while with State banks and trust companies membership is optional. There are no depositors in the Reserve Bank of a given district except the member banks themselves and the United States Government, The Government under the Act no longer deposits its reserve funds in ordinary banks, as formerly, or lets them lie unused in the vaults of the sub-treasuries; but places them in the Federal Reserve Banks, subject to the supervision of the Federal Reserve Board at Washington, and to the direct authority over them of the Secretary of Treasury.

The Act provided for an issue of $500,000,000 of new Treasury notes of the United States, to be apportioned among the several Federal Reserve Banks, and to be supplied by them in turn to the ordinary member banks at such times as money is especially needed for the transaction of business, as when crops are being moved and so on. This supply of

currency is secured by the banks depositing commercial paper with the Federal Reserve Bank.

§ 196. **How Panics Are Prevented.**—In ordinary times the business of banking goes on very much as before the passage of the new Act, and merchants and citizens can see little difference in conditions. The ordinary banks continue to be independent concerns, receiving deposits and lending money as before. But in exceptional times, as in 1907, a great difference will be visible. In the panic of 1907 the banks would not even allow a depositor to draw out his own money—much less would they make the customary loans on commercial paper, or other approved security, even to their most reliable customers. Thus, at the very time when the banks were most needed to aid and encourage business, they ceased their functions and only magnified and intensified the business troubles that with a better and more elastic system they could have prevented. The first symptom of financial stress led every banker to protect his own reserves, lest he might become the victim of a "run." He lacked the support of a higher financial power, such as is provided by the Federal Reserve Bank system, which promises a complete remedy for such conditions, by supplying the funds to meet emergencies upon the deposit of ordinary commercial paper by the member banks. All the banks are now practically federated for mutual help under the auspices of a central Government board. For the first time our national banking system possesses the real strength that lies in unity.

§ 197. **Federal Reserve Agents.**—In each district there is a Federal Reserve Agent appointed by the Federal Reserve Board, who acts as chairman of the board of directors of a Reserve Bank, maintains a local office of the Federal Reserve Board, makes reports to that body and generally acts as its representative in that district. Thus the central Board is enabled to keep in close touch with business conditions in each district at all times and seasons.

The chief executive officer of each Reserve Bank is known as its governor, and is appointed as such by the directors of the bank. He presides at meetings of the executive committee, makes transfers of securities, and jointly with the cashier signs all certificates of stock of the bank. The other officers of each Reserve Bank (all chosen by the board of directors) consist of a first and second vice-governor and a secretary-treasurer or cashier.

§ 198. **Attitude Toward Member Banks.**—The Federal Reserve Bank of each district, belongs to its members. They have furnished the entire capitalization and are the sole depositors; they have elected six of the nine directors and the directors in turn have elected all the officers of the bank except the chairman of the Board. Furthermore, the Federal Reserve Board has stated its policy to be that it does not desire to interfere with the management of the banks except to see that the law is observed. Therefore, the attitude toward member banks is one of cordial co-operation for the purpose of securing for them and through them for the business com-

munity and the public every advantage intended and possible under the Act.

Co-operation between the Federal Reserve Banks also has been evidenced by the organization of a conference of Governors for the purpose of considering problems and questions that have arisen, and exchanging views in order that all may have the benefit of the views of each.

§ 199. **A Great Constructive Measure.**—The Federal Reserve Act became a law as a great, far-reaching constructive measure to bring co-ordination and unity, consolidation and central control, out of our separated commercial banks under individual control. It does this and more. The Federal Reserve Bank system forms a financial base on which commercial business may depend in its expansion and extension into new fields. Producers and dealers in commodities need no longer fear an inadequate money market on which to float commercial paper. The Reserve Banks created are not supposed to do any business of moment or to initiate anything. All that is left to the public, and all banking is done as before through the already existing banks. The new system provides a place, a fund, a means of creating credit, a system of exchanges, designed to be equal to any emergency which the commercial banks of the country will have to face, and to supply all the fair, legitimate needs of commerce now apparent.

The great object of the Act is to aid business—its regulation of banks is because they are instruments and most important aids of commerce.

Under the Reserve Bank system, the assurance the

member banks have is the assurance to the management that they can always cash in their commercial notes and meet their obligations in any emergency; the assurance to the depositor that his money will be paid to him on demand in cash in any emergency; the assurance to their commercial borrowers that they will not be compelled to shut down for lack of funds to buy goods or material, or of currency for their payrolls.

§ 200. Practical Guarantee of Deposits.—The original National Bank Act provided for supervision of banks, and its amendments increased the efficiency of this supervision. The Federal Reserve Act provides additional safeguards. The Comptroller of the Currency said: "Under the provisions of the new law, the failure of efficiently managed banks is practically impossible."

The more stringent oversight and regulation provided by the Act gives a hope, at least, that every member bank is solvent, and will so remain or be compelled to close; and that, should it close, its assets will pay its liabilities; that is, it practically gives every depositor in a member bank additional assurance that his money in the bank is safe.

§ 201. Amendments to the Act.—Since its passage in 1913, amendments have been made to the Federal Reserve Act by Congress in each year up to 1921. Its principal provisions, as amended, appear in the following pages. It may also be noted that the operations of the Federal Reserve Banks and member banks of the Reserve system are or have been affected, directly or indirectly, by certain sections of the following Acts of Congress;

Clayton Anti-Trust Act, approved October 15, 1914, as amended by Kern Amendment, approved May 15, 1916, as amended by the act approved May 26, 1920.

Amendment to Postal Savings Act, approved May 18, 1916.

Farm Loan Act, approved July 17, 1916.

First Liberty Bond Act, approved April 24, 1917.

Second Liberty Bond Act, Approved September 24, 1917.

Third Liberty Bond Act, approved April 4, 1918.

War Finance Corporation Act, approved April 5, 1918, as amended by the Victory Liberty Loan Act, approved March 3, 1919.

An Act To Conserve the Gold Supply of the United States, etc., approved April 23, 1918.

Trading With the Enemy Act, as amended by the act approved September 24, 1918.

Section 5172, Revised Statutes, as amended by act of March 3, 1919.

Section 5200 Revised Statutes, as amended by act of September 24, 1918, and act of October 22, 1919.

Section 5202, Revised Statutes, as amended by War Finance Corporation Act, approved April 5, 1918, and act of October 22, 1919.

Sections 5208 and 5209, Revised Statutes, as amended by act of September 26, 1918.

Revenue Act of 1918, approved February 24, 1919.

Transportation Act of 1920, approved February 28, 1920.

Appropriation Act of 1920, approved May 29, 1920.

§ 202. **Terms of the Act.**—The full title of the Federal Reserve Act is: "An Act To provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes."

Wherever the word "bank" is used in this Act, the word shall be held to include State bank, banking association, and trust company, except where national banks or Federal Reserve banks are specifically referred to.

The terms "national bank" and "national banking association" used in this Act shall be held to be synonymous and interchangeable. The term "member bank" shall be held to mean any national bank, State bank, or bank or trust company which has become a member of one of the reserve banks created by this Act. The term "board" shall be held to mean Federal Reserve Board; the term "district" shall be held to mean Federal Reserve district; the term "reserve bank" shall be held to mean Federal Reserve bank.

§ 203. **Organization of Reserve Banks.**—After providing for an Organization Committee to designate the Federal Reserve Cities, etc., the act provided as follows:

Under regulations to be prescribed by the organization committee, every national banking association in the United States is hereby required, and every eligible bank in the United States and every trust company within the District of Columbia, is hereby authorized to signify in writing, within sixty days

after the passage of this Act, its acceptance of the terms and provisions hereof. When the organization committee shall have designated the cities in which Federal Reserve banks are to be organized, and fixed the geographical limits of the Federal Reserve districts, every national banking association within that district shall be required within thirty days after notice from the organization committee, to subscribe to the capital stock of such Federal Reserve bank in a sum equal to six per centum of the paid-up capital stock and surplus of such bank.

Any national bank failing to signify its acceptance of the terms of this Act within the sixty days aforesaid, shall cease to act as a reserve agent, upon thirty days' notice, to be given within the discretion of the said organization committee or of the Federal Reserve Board.

Should any national banking association in the United States now organized fail within one year after the passage of this Act to become a member bank or fail to comply with any of the provisions of this Act applicable thereto, all of the rights, privileges, and franchises of such association granted to it under the National Bank Act, or under the provisions of this Act, shall be thereby forfeited.

§ 204. Capital Stock Subscribed by Banks.— Should the subscriptions by banks to the stock of said Federal Reserve banks or any one or more of them be, in the judgment of the organization committee, insufficient to provide the amount of capital required therefor, then and in that event the said organization committee may, under conditions and regulations to be prescribed by it, offer to public

subscription at par such an amount of stock in said Federal Reserve banks, or any one or more of them, as said committee shall determine, subject to the same conditions as to payment and stock liability as provided for member banks.

No individual, copartnership, or corporation other than a member bank of its district shall be permitted to subscribe for or to hold at any time more than $25,000 par value of stock in any Federal Reserve bank. Such stock shall be known as public stock and may be transferred on the books of the Federal Reserve bank by the chairman of the board of directors of such bank.

No Federal Reserve bank shall commence business with a subscribed capital less than $4,000,000. The organization of Reserve districts and Federal Reserve cities shall not be construed as changing the present status of reserve cities and central reserve cities, except in so far as this Act changes the amount of reserves that may be carried with approved Reserve agents located therein.

§ 205. **Branch Banks.**—The Federal Reserve Board may permit or require any Federal Reserve bank to establish branch banks within the Federal Reserve district in which it is located or within the district of any Federal Reserve bank which may have been suspended. Such branches, subject to such rules and regulations as the Federal Reserve Board may prescribe, shall be operated under the supervision of a board of directors to consist of not more than seven nor less than three directors, of whom a majority of one shall be appointed by the Federal Reserve bank of the district, and the remaining directors

by the Federal Reserve Board. Directors of branch banks shall hold office during the pleasure of the Federal Reserve Board.

§ 206. Corporate Power of Reserve Banks.—Upon the filing of a certificate of organization with the Comptroller of the Currency, the said Federal Reserve bank shall become a body corporate, and as such shall have power—

First. To adopt and use a corporate seal.

Second. To have succession for a period of twenty years from its organization unless it is sooner dissolved by an Act of Congress, or unless its franchise becomes forfeited by some violation of law.

Third. To make contracts.

Fourth. To sue and be sued, complain and defend, in any court of law or equity.

Fifth. To appoint by its board of directors such officers and employees as are not otherwise provided for in this Act, to define their duties, require bonds of them and fix the penalty thereof, and to dismiss at pleasure such officers or employees.

Sixth. To prescribe by its board of directors, bylaws not inconsistent with law, regulating the manner in which its general business may be conducted, and the privileges granted to it by law may be exercised and enjoyed.

Seventh. To exercise by its board of directors, or duly authorized officers or agents, all powers specifically granted by the provisions of this Act and such incidental powers as shall be necessary to

carry on the business of banking within the limitations prescribed by this Act.

Eighth. Upon deposit with the Treasurer of the United States of any bonds of the United States in the manner provided by existing law relating to national banks, to receive from the Comptroller of the Currency circulating notes in blank, registered and countersigned as provided by law, equal in amount to the par value of the bonds so deposited, such notes to be issued under the same conditions and provisions of law as relate to the issue of circulating notes of national banks secured by bonds of the United States bearing the circulating privilege, except that the issue of such notes shall not be limited to the capital stock of such Federal reserve bank.

§ **207. Board of Directors.**—Every Federal Reserve bank shall be conducted under the supervision and control of a board of directors. Said board shall administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks and shall, subject to the provisions of law and the orders of the Federal Reserve Board, extend to each member bank such discounts, advancements and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks.

Such board of directors shall be selected as hereinafter specified and shall consist of nine members, holding office for three years, and divided into three classes, designated as classes A, B and C.

Class A shall consist of three members, who shall

be chosen by and be representative of the stock-holding banks.

Class B shall consist of three members, who at the time of their election shall be actively engaged in their district in commerce, agriculture or some other industrial pursuit.

Class C shall consist of three members who shall be designated by the Federal Reserve Board. When the necessary subscriptions to the capital stock have been obtained for the organization of any Federal reserve bank, the Federal Reserve Board shall appoint the class C directors and shall designate one of such directors as chairman of the board to be selected. Pending the designation of such chairman, the organization committee shall exercise the powers and duties appertaining to the office of chairman in the organization of such Federal Reserve bank.

No senator or representative in Congress shall be a member of the Federal Reserve Board or an officer or a director of a Federal Reserve bank.

No director of class B shall be an officer, director, or employee of any bank.

No director of class B shall be an officer, director, employee, or stockholder of any bank.

Directors of class A and class B shall be chosen in the following manner:

The Federal Reserve Board shall classify the member banks of the district into three general groups or divisions, designating each group by number. Each group shall consist as nearly as may be of banks of similar capitalization. Each member

bank shall be permitted to nominate to the chairman of the board of directors of the Federal Reserve bank of the district one candidate for director of class A and one candidate for director of class B. The candidate so nominated shall be listed by the chairman, indicating by whom nominated, and a copy of said list shall, within fifteen days after its completion, be furnished by the chairman to each member bank. Each member bank by a resolution of the board or by an amendment to its by-laws shall authorize its president, cashier, or some other officer to cast the vote of the member bank in the elections of class A and class B directors.

Class C directors shall be appointed by the Federal Reserve Board. They shall have been for at least two years residents of the district for which they are appointed, one of whom shall be designated by said board as chairman of the board of directors of the Federal Reserve bank and as "Federal reserve agents." He shall be a person of tested banking experience, and in addition to his duties as chairman of the board of directors of the Federal Reserve bank he shall be required to maintain, under regulations to be established by the Federal Reserve Board, a local office of said board on the premises of the Federal Reserve Bank. He shall make regular reports to the Federal Reserve Board and shall act as its official representative for the performance of the functions conferred upon it by this act.

§ 208. Dividends and Franchise Tax.—The capital stock of each Federal Reserve bank shall be divided into shares of $100 each. The outstanding capital stock shall be increased from time to time as

member banks increase their capital stock and surplus or as additional banks become members, and may be decreased as member banks reduce their capital stock or surplus or cease to be members. Shares of the capital stock of Federal Reserve banks owned by member banks shall not be transferred or hypothecated.

After all necessary expenses of a Federal reserve bank have been paid or provided for, the stockholders shall be entitled to receive an annual dividend of six per centum on the paid-in capital stock, which dividend shall be cumulative. After the aforesaid dividend claims have been fully met, the net earnings shall be paid to the United States as a franchise tax.

The net earnings derived by the United States from Federal Reserve banks shall, in the discretion of the Secretary, be used to supplement the gold reserve held against outstanding United States notes, or shall be applied to the reduction of the outstanding bonded indebtedness of the United States under regulations to be prescribed by the Secretary of the Treasury.

§ 209. **Nationalization of State Banks.**—Section 5154, United States Revised Statutes, is hereby amended to read as follows:

Any bank incorporated by special law of any State or of the United States or organized under the general laws of any State of the United States and having an unimpaired capital sufficient to entitle it to become a national banking association under the provisions of the existing laws may, by the vote of the shareholders owning not less than fifty-one per

centum of the capital stock of such bank or banking association, with the approval of the Comptroller of the Currency be converted into a national banking association, with any name approved by the Comptroller of the Currency: Provided, however, That said conversion shall not be in contravention of the State law.

When the Comptroller has given to such bank or banking association a certificate that the provisions of this Act have been complied with, such bank or banking association, and all its stockholders, officers, and employees, shall have the same powers and privileges, and shall be subject to the same duties, liabilities, and regulations, in all respects, as shall have been prescribed by the Federal Reserve Act and by the national banking Act for associations originally organized as national banking associations.

§ 210. **State Banks as Members.**—Any bank incorporated by special law of any State, or organized under the general laws of any State or of the United States, desiring to become a member of the Federal Reserve System, may make application to the Federal Reserve Board, under such rules and regulations as it may prescribe, for the right to subscribe to the stock of the Federal Reserve bank organized within the district in which the applying bank is located. Such application shall be for the same amount of stock that the applying bank would be required to subscribe to as a national bank. The Federal Reserve Board, subject to such conditions as it may prescribe, may permit the applying bank to become a stockholder of such Federal Reserve bank.

In acting upon such applications the Federal Re-

serve Board shall consider the financial condition of the applying bank, the general character of its management, and whether or not the corporate powers exercised are consistent with the purpose of this act.

Whenever the Federal Reserve Board shall permit the applying bank to become a stockholder in the Federal Reserve bank of the district its stock subscription shall be payable on call of the Federal Reserve Board, and stock issued to it shall be held subject to the provisions of this act.

As a condition of membership such banks shall likewise be subject to examinations made by direction of the Federal Reserve Board or of the Federal Reserve bank by examiners selected or approved by the Federal Reserve Board.

Whenever the directors of the Federal Reserve bank shall approve the examinations made by the State authorities, such examinations and the reports thereof may be accepted in lieu of examinations made by examiners selected or approved by the Federal Reserve Board: Provided, however, That when it deems it necessary the board may order special examinations by examiners of its own selection and shall in all cases approve the form of the report. The expenses of all examinations, other than those made by State authorities, shall be assessed against and paid by the banks examined.

§ 211. **Federal Reserve Board.**—A Federal Reserve Board is hereby created which shall consist of seven members including the Secretary of the Treasury and the Comptroller of the Currency, who

shall be members ex officio, and five members appointed by the President of the United States, by and with the advice and consent of the Senate. The five members of the Federal Reserve Board appointed by the President and confirmed as aforesaid shall devote their entire time to the business of the Federal Reserve Board and shall each receive an annual salary of $12,000, payable monthly together with actual necessary traveling expenses, and the Comptroller of the Currency, as ex officio member of the Federal Reserve Board, shall, in addition to the salary now paid him as Comptroller of the Currency, receive the sum of $7,000 annually for his services as a member of said board.

Of the five members thus appointed by the President at least two shall be persons experienced in banking or finance. One shall be designated by the President to serve for two, one for four, one for six, one for eight, and one for ten years, and thereafter each member so appointed shall serve for a term of ten years unless sooner removed for cause by the President. Of the five persons thus appointed one shall be designated by the President as governor and one as vice governor of the Federal Reserve Board. The governor of the Federal Reserve Board, subject to its supervision shall be the active executive officer.

§ 212. **Powers of the Board.**—The Federal Reserve Board shall be authorized and empowered:

(a) To examine at its discretion the accounts, books and affairs of each Federal Reserve bank and of each member bank and to require such statements and reports as it may deem necessary. The said board shall publish once each week a statement show-

ing the condition of each Federal Reserve bank and a consolidated statement for all Federal Reserve banks.

(b) To permit, or, on the affirmative vote of at least five members of the Reserve banks to rediscount the discount paper of other Federal Reserve banks at rates of interest to be fixed by the Federal Reserve Board.

(c) To suspend for a period not exceeding thirty days, and from time to time to renew such suspension for periods not exceeding fifteen days, any reserve requirements specified in this Act.

(d) To supervise and regulate through the bureau under the charge of the Comptroller of the Currency the issue and retirement of Federal reserve notes, and to prescribe rules and regulations under which such notes may be delivered by the Comptroller to the Federal reserve agents applying therefor.

(e) To add to the number of cities classified as reserve and central reserve cities under existing law in which national banking associations are subject to the reserve requirements set forth in this Act; or to reclassify existing reserve and central reserve cities or to terminate their designation as such.

(f) To suspend or remove any officer or director of any Federal Reserve bank.

(g) To require the writing off of doubtful or worthless assets upon the books and balance sheets of Federal Reserve banks.

(h) To suspend, for the violation of any of the provisions of this Act, the operations of any Federal Reserve bank, to take possession thereof, administer

the same during the period of suspension, and, when deemed advisable, to liquidate or reorganize such bank.

(i) To require bonds of Federal reserve agents, to make regulations for the safeguarding of all collateral, bonds, Federal reserve notes, money or property of any kind deposited in the hands of such agents.

(j) To exercise general supervision over said Federal Reserve banks.

(k) To grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located.

(l) To employ such attorneys, experts, assistants, clerks, or other employees as may be deemed necessary to conduct the business of the board.

§ 213. **Federal Advisory Council.**—There is hereby created a Federal Advisory Council, which shall consist of as many members as there are Federal Reserve districts. Each Federal Reserve bank by its board of directors shall annually select from its own Federal Reserve district one member of said council, who shall receive such compensation and allowances as may be fixed by his board of directors

subject to the approval of the Federal Reserve Board. The meetings of said advisory council shall be held at Washingaon, District of Columbia, at least four times year, and oftener if called by the Federal Reserve Board.

The Federal Advisory Council shall have power, by itself or through its officers, (1) to confer directly with the Federal Reserve Board on general business conditions; (2) to make oral or written representations concerning matters within the jurisdiction of said board; (3) to call for information and to make recommendations in regard to discount rates, rediscount business, note issues, reserve conditions in the various districts the purchase and sale of gold or securities by reserve banks, open-market operations by said banks, and the general affairs of the reserve banking system.

§ 214. **Powers of Federal Reserve Banks.**—Any Federal reserve bank may receive from any of its member banks, and from the United States, deposits of current funds in lawful money, national-bank notes, Federal Reserve notes, or checks, and drafts, payable upon presentation, and also, for collection, maturing notes and bills; or, solely for purposes of exchange or of collection, may receive from other Federal Reserve banks deposits of current funds in lawful money, national-bank notes, or checks upon other Federal Reserve banks, and checks and drafts, payable upon presentation within its district, and maturing notes and bills payable within its district; or, solely for the purposes of exchange or of collection, may receive from any non member bank or trust company deposits of current funds in

lawful money, national-bank notes, Federal reserve notes, checks and drafts payable upon presentation, or maturing notes and bills: Provided, Such non member bank or trust company maintains with the Federal Reserve bank of its district a balance sufficient to offset the items in transit held for its account by the Federal Reserve bank.

§ 215. **Discount of Commercial Paper.**—Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice and protest by such bank as to its own indorsement exclusively, any Federal Reserve bank may discount notes, drafts and bills of exchange arising out of actual commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Federal Reserve Board to have the right to determine or define the charter of the paper thus eligible for discount, within the meaning of this Act. Nothing in this Act contained shall be construed to prohibit such notes, drafts, and bills of exchange secured by staple agricultural products, or other goods, wares, or merchandise from being eligible for such discount; but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States. Notes, drafts, and bills admitted to discount under the terms of this paragraph must have a maturity at the time of discount of not more than ninety days, exclusive of days of grace:

Provided, That notes, drafts, and bills drawn or issued for agricultural purposes or based on live stock and having a maturity not exceeding six months, exclusive of days of grace, may be discounted in an amount to be limited to a percentage of the assets of the Federal Reserve bank, to be ascertained and fixed by the Federal Reserve Board.

The aggregate of such notes, drafts, and bills bearing the signature or indorsement of any one borrower, whether a person, company, firm, or corporation, rediscounted for any one bank shall at no time exceed ten per centum of the unimpaired capital and surplus of said bank; but this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values.

§ 216. **Advances to Member Banks.**—Any Federal Reserve bank may make advances to its member banks on their promissory notes for a period not exceeding fifteen days at rates to be established by such Federal Reserve banks subject to the review and determination of the Federal Reserve Board, provided such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal Reserve banks under the provisions of this Act, or by the deposit or pledge of bonds or notes of the United States.

§ 217. **Government Deposits.**—The money held in the general fund of the Treasury, except the five per centum fund for the redemption of outstanding national-bank notes and the funds provided in this Act for the redemption of Federal reserve notes may, upon the direction of the Secretary of the Treas-

ury, be deposited in Federal Reserve banks, which banks, when required by the Secretary of the Treasury, shall act as fiscal agents of the United States; and the revenues of the Government or any part thereof may be deposited in such banks, and disbursements may be made by checks drawn against such deposits.

No public funds of the Philippine Islands, or of the postal savings or any Government funds, shall be deposited in the continental United States in any bank not belonging to the system established by this Act: Provided, however, That nothing in this Act shall be construed to deny the right of the Secretary of the Treasury to use member banks as depositories.

§ 218. **Note Issues.**—Federal reserve notes, to be issued at the discretion of the Federal Reserve Board for the purpose of making advances to Federal Reserve banks through the Federal reserve agents as hereinafter set forth and for no other purpose, are hereby authorized. The said notes shall be obligations of the United States and shall be receivable by all national and member banks and Federal Reserve banks and for all taxes, customs, and other public dues. They shall be redeemed in gold on demand at the Treasury Department of the United States, in the city of Washington, District of Columbia, or in gold or lawful money at any Federal reserve bank.

Any Federal Reserve bank may make application to the local Federal reserve agent for such amount of the Federal reserve notes hereinbefore provided for as it may require. Such application shall be accompanied with a tender to the local Federal reserve

agent of collateral in amount equal to the sum of the Federal reserve notes thus applied for and issued pursuant to such application.

§ 219. **Reserves to Be Maintained.**—Every Federal Reserve bank shall maintain reserves in gold or lawful money of not less than thirty-five per centum against its deposits and reserves in gold of not less than forty per centum against its Federal reserve notes in actual circulation: Provided, however, That when the Federal reserve agent holds gold certificates as collateral for Federal reserve notes issued to the bank such gold or gold certificates shall be counted as part of the gold reserve which such bank is required to maintain against its Federal reserve notes in actual circulation.

The Federal Reserve Board shall require each Federal Reserve bank to maintain on deposit in the Treasury of the United States a sum in gold sufficient in the judgment of the Secretary of the Treasury for the redemption of the Federal reserve notes issued to such banks, but in no event less than five per centum of the total amount of notes issued less the amount of gold or gold certificates held by the Federal reserve agent as collateral security; but such deposit of gold shall be counted and included as part of the forty per centum reserve hereinbefore required.

§ 220. **Notes for Circulation.**—In order to furnish suitable notes for circulation as Federal reserve notes, the Comptroller of the Currency shall, under the Secretary of the Treasury, cause plates and dies to be engraved in the best manner to guard against

counterfeits and fraudulent alterations, and shall have printed therefrom and numbered such quantities of such notes of the denominations of \$5, \$10, \$20, \$50, \$100, \$500, \$1000, \$5000, \$10,000 as may be required to supply the Federal Reserve banks. Such notes shall be in form and tenor as directed by the Secretary of the Treasury under the provisions of this Act and shall bear the distinctive numbers of the several Federal Reserve banks through which they are issued.

When such notes have been prepared they shall be deposited in the Treasury, or in the subtreasury or mint of the United States nearest the place of business of each Federal Reserve bank and shall be held for the use of such bank subject to the order of the Comptroller of the Currency for their delivery, as provided by this Act.

So much of the provisions of section 5159 of the Revised Statutes of the United States, and section 4 of the act of June 20, 1874, and section 8 of the act of July 12, 1882, and of any other provisions of existing statutes as require that before any national banking association shall be authorized to commence banking business it shall transfer and deliver to the Treasurer of the United States a stated amount of United States registered bonds, and so much of those provisions or of any other provisions of existing statutes as require any national banking association now or hereafter organized to maintain a minimum deposit of such bonds with the Treasurer is hereby repealed.

Note.—Under act of April 23, 1918, Federal reserve banks may issue Federal reserve bank notes in any denominations, including $1 and $2, against the security of United States certificates of indebtedness to the extent permitted by that act.

§ 221. **Bank Reserves.**—Demand deposits within the meaning of this Act shall comprise all deposits payable within thirty days, and time deposits shall comprise all deposits payable after thirty days, all savings accounts and certificates of deposit which are subject to not less than thirty days' notice before payment, and all postal savings deposits.

Every bank, banking association, or trust company which is or which becomes a member of any Federal Reserve bank shall establish and maintain reserve balances with its Federal Reserve bank as follows:

(a) If not in a reserve or central reserve city, as now or hereafter defined, it shall hold and maintain with the Federal Reserve bank of its district an actual net balance equal to not less than seven per centum of the aggregate amount of its demand deposits and three per centum of its time deposits.

(b) If in a reserve city, as now or hereafter defined, it shall hold and maintain with the Federal Reserve bank of its district an actual net balance equal to not less than ten per centum of the aggregate amount of its demand deposits and three per centum of its time deposits.

(c) If in a central reserve city, as now or hereafter defined, it shall hold and maintain with the Federal Reserve bank of its district an actual net balance equal to not less than thirteen per centum of the aggregate amount of its demand deposits and three per centum of its time deposits.

§ 222. Bank Examinations.—Section 5240, United States Reserve Statutes, is amended to read as follows:

"The Comptroller of the Currency, with the approval of the Secretary of the Treasury, shall appoint examiners who shall examine every member bank at least twice in each calendar year and oftener if considered necessary: Provided, however, That the Federal Reserve Board may authorize examination by the State authorities to be accepted in the case of State banks and trust companies and may at any time direct the holding of a special examination of State banks or trust companies that are stockholders in any Federal Reserve bank. The examiner making the examination of any national bank, or of any other member bank, shall have power to make a thorough examination of all the affairs of the bank, and in doing so shall have power to administer oaths and to examine any of the officers and agents thereof under oath and shall make a full and detailed report of the condition of said bank to the Comptroller of the Currency.

The Federal Reserve Board shall, at least once each year, order an examination of each Federal Reserve bank, and upon joint application of ten member banks the Federal Reserve Board shall order a special examination and report of the condition of any Federal Reserve bank.

§ 223. Loans on Farm Lands.—Any national banking association not situated in a central reserve city may make loans secured by improved and unencumbered farm land situated within its Federal

Reserve district or within a radius of one hundred miles of the place in which such bank is located, irrespective of district lines, and may also make loans secured by improved and unencumbered real estate located within one hundred miles of the place in which such bank is located, irrespective of district lines; but no loan made upon the security of such farm land shall be made for a longer time than five years, and no loan made upon the security of such real estate as distinguished from farm land shall be made for a longer time than one year, nor shall the amount of any such loan, whether upon such farm land or upon such real estate, exceed fifty per centum of the actual value of the property offered as security. Any such bank may make such loans, whether secured by such farm land or such real estate, in an aggregate sum equal to twenty-five per centum of its capital and surplus or to one-third of its time deposits, and such banks may continue hereafter as heretofore to receive time deposits and to pay interest on the same.

§ 224. **Foreign Branches.**—Any national banking association possessing a capital and surplus of $1,000,000 or more may file application with the Federal Reserve Board for permission to exercise, upon such conditions and under such regulations as may be prescribed by the said board, either or both of the following powers:

First. To establish branches in foreign countries or dependencies or insular possessions of the United States for the furtherance of the foreign commerce of the United States, and to act if required to do so as fiscal agents of the United States.

Second. To invest an amount not exceeding in the aggregate ten per centum of its paid-in capital stock and surplus in the stock of one or more banks or corporations chartered or incorporated under the laws of the United States or of any State thereof, and principally engaged in international or foreign banking, or banking in a dependency or insular possession of the United States either directly or through the agency, ownership, or control of local institutions in foreign countries, or in such dependencies or insular possessions.

§ 225. **Gold Standard Maintained.**—All Provisions of law inconsistent with or superseded by any of the provisions of this Act are to that extent and to that extent only hereby repealed: Provided, Nothing in this Act contained shall be construed to repeal the parity provision or provisions contained in an Act approved March 14, 1900, entitled "An Act to define and fix the standard of value to maintain the parity of all forms of money issued of coined by the United States, to refund the public debt, and for other purposes," and the Secretary of the Treasury, may for the purpose of maintaining such parity and to strengthen the gold reserve, borrow gold on the security of United States bonds authorized by section two of the Act last referred to or for one-year gold notes bearing interest at a rate of not to exceed three per centum per annum, or sell the same if necessary to obtain gold. When the funds of the Treasury on hand justify, he may purchase and retire such outstanding bonds and notes.

§ 226. **Federal Reserve Bank Earnings.**—The Federal Reserve Act wisely permits each Federal

Reserve Bank to accumulate a surplus fund out of its earnings equal to 100 per cent of its subscribed capital, before the franchise tax becomes payable. This provision probably will avoid the necessity of payment of the remaining 50 per cent on stock subscriptions of member banks not yet called in. But after the 100 per cent surplus is accumulated and 6 per cent in dividends is paid annually on paid-in capital stock, 90 per cent of net profits remaining must be paid in to the already existing surplus.

Large earnings are possible because of the ability of the Federal Reserve Bank to rediscount in large volume for its member banks, due to needs of agriculture, commerce and industry. This ability to rediscount in large volume is primarily based on the power granted by law to issue Federal Reserve notes in payment for the proceeds of those rediscounts.

But the Federal Reserve note is the promise of the United States to pay to the bearer, on demand, so many dollars. Therefore the Federal Reserve Bank itself really borrows credit from the government in the form of Federal Reserve notes, distributes this credit among its member banks as their needs require, and virtually pays interest to the government, in the form of franchise tax, to the amount of 90 per cent of its net earnings above dividend requirements, whether those earnings be large or small. The Federal Reserve agent at each Federal Reserve Bank holds collateral in the form of gold or commercial paper to secure the government for the notes issued in his district.

Moreover, the Federal Reserve Act specifies that the Secretary of the Treasury may disburse the pro-

ceeds of the franchise tax only by increasing the gold reserve against U. S. notes (greenbacks), for which ample reserve already has been provided, or employ it for the retirement of funded obligations of the United States. It is probable, therefore, that the entire franchise tax will be applied toward the payment of Liberty bonds and Victory notes before their maturity, thus returning directly to the public 90 per cent of the profits to which it contributed, and which there is some disposition to criticize.

§ **227. Example.**—The net earnings of the Federal Reserve Bank of Chicago for 1920 were distributed as follows:

Dividends	$ 792,769.21
Transferred to Surplus	14,688,499.56
Franchise Tax (paid to government)	10,394,480.26
Total	$25,875,749.03

Now observe these figures of the Federal Reserve Bank of Chicago covering its operations during 1920:

Paid-in Capital, average	$ 13,267,000
Member Bank reserves, average	258,457,176
Federal Reserve notes in circulation, average	$531,074,275

and it will be noted that practically two-thirds of its actual working power was in the form of Federal Reserve notes or borrowed government credit. Hence the return (in franchise tax guise) to the government was a very modest one, even on the volume of circulation (54.8 per cent, or $290,769,761.00) not di-

rectly covered by gold; yet the government received all the profits above surplus and dividend requirements. The direct benefits accruing to the banks of the district and through them to the business public were very large by comparison.

§ 228. Banking Power of the United States.—The banking power of the United States in June, 1919, as represented by capital, surplus and other profits, circulation and deposits of national and other reporting banks, together with the estimated amount of funds of this character in nonreporting banks, as well as the paid-in capital, government and reserve deposits, and Federal reserve notes in circulation as shown by the statement of the Federal Reserve banks as of June 30, 1919, was $45,756,300,000.

The banking power of the United States alone today is three times as great as the banking power of the world as it stood in 1890, when Mulhall's estimate placed the world's banking power at $15,585,000,000, and the banking power of the United States is now about nine times greater than Mulhall's estimate of our banking power in 1890, which was given by him at $5,150,000,000.

	*Total (1919)
National banks	$16,090,100,000
State (etc.) banks	23,810,700,000
Nonreporting banks	610,200,000
Federal Reserve banks	5,245,300.000
Total	$45,756,300,000

*Capital paid in, surplus and profits, deposits and Federal notes in circulation.

FEDERAL RESERVE BANKS

Condition July 4, 1919

District	Gold Reserve	Bills on Hand	Resources	Note circul'n
1. Boston ...	$105,428,000	$172,407,000	$373,711,000	$182,631,000
2. New York	656,095,000	853,170,000	1,818,155,000	762,915,000
3. Philadelp'a	127,492,000	189,316,000	413,537,000	203,310,000
4. Cleveland.	202,564,000	154,302,000	440,767,000	217,567,000
5. Richmond	66,527,000	94,995,000	231,199,000	109,640,000
6. Atlanta ..	75,690,000	88,948,000	211,656,000	117,320,000
7. Chicago ..	421,900,000	284,413,000	825,849,000	429,248,000
8. St. Louis .	92,970,000	62,298,000	233,036,000	104,350,000
9. Minneapolis	82,822,000	61,217,000	163,774,000	82,203,000
10. Kansas City	81,460,000	84,832,000	240,912,000	94,044,000
11. Dallas ...	32,334,000	55,050,000	123,706,000	47,908,000
12. San Fr'isco	183,664,000	124,759,000	346,806,000	201,212,000

Questions for Review, Chapter IX.

1. What is the main purpose of the Federal Reserve Bank system?

2. How many Reserve Districts are there, and where are the Reserve Banks located?

3. Who are the depositors in a Federal Reserve Bank? Who are the shareholders?

4. From what sources does the Reserve Bank derive funds for use in an emergency?

5. How are panics to be prevented under the operation of the Federal Reserve Act?

6. How is the Federal Reserve Board constituted, and what are its duties?

7. How many members constitute the Federal Advisory Council, and what are its duties?

8. How are the executive officers of a Reserve Bank appointed, and what are they called?

9. In what way does the new law operate as a practical guarantee of deposits in the member banks?

10. What is the effect of the Federal Reserve System on mercantile business and credit?

11. What are the chief characteristics of an ideal currency system for the United States?

12. How does the Federal Reserve System encourage the handling of commercial paper by member banks?

13. What are the corporate powers of Federal Reserve banks?

14. What are the different classes of directors selected for the Reserve banks?

15. How are the member banks of a Federal Reserve district classified?

16. Are State banks encouraged to become members of the Reserve system, and if so, under what conditions?

17. What are the powers of the Federal Reserve Board with regard to the examination of banks?

CHAPTER X

Federal Land Bank System

Section 229. Primary Purpose of the System.—The Federal Farm Loan Act, also popularly called the "rural credits law," was passed by both houses of Congress in May, 1916. It was approved by President Wilson and became a law July 17, 1916.

The primary purpose of this act was to promote agricultural prosperity by enabling farmers to borrow money on farm mortgage security at a reasonable rate of interest and for relatively long periods of time. To attain this object, two farm mortgage systems are provided: (1) a system operating through regional land banks; (2) a system operating through joint stock land banks.

To attract money to the farm loan field, the act provides a method whereby those who have money to lend can find safe investments in the form of debentures or bonds, of small and large denominations, issued by the banks and based on the security of mortgages on farm lands.

§ 230. Federal Farm Loan Act.—The full title of the Farm Loan Act states its purpose as follows: "An Act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest

upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes." Following are some of the provisions of the Act:

§ **231. The Farm Loan Board.**—That there shall be established at the seat of government in the Department of the Treasury a bureau charged with the execution of this act and of all acts amendatory thereof, to be known as the Federal Farm Loan Bureau, under the general supervision of a Federal Farm Loan Board.

Said Federal Farm Loan Board shall consist of five members including the Secretary of the Treasury, who shall be a member and chairman ex-officio, and four members to be appointed by the President of the United States, by and with the advice and consent of the Senate. Of the four members to be appointed by the President, not more than two shall be appointed from one political party, and all four of said members shall be citizens of the United States and shall devote their entire time to the business of the Federal Farm Loan Board; they shall receive an annual salary of $10,000 payable monthly, together with actual necessary traveling expenses.

§ **232. Federal Land Banks.**—The Federal Farm Loan Board shall divide the continental United States, excluding Alaska, into twelve districts, which shall be known as Federal land bank districts, and may be designated by number. Said districts shall be apportioned with due regard to the farm loan needs of the country, but no such district shall contain a fractional part of any State. The boundaries

thereof may be readjusted from time to time in the discretion of said board.

The Federal Farm Loan Board shall establish in each Federal land bank district a Federal Land Bank, with its principal office located in such city within the district as said board shall designate. Each Federal Land Bank shall include in its title the name of the city in which it is located. Subject to the approval of the Federal Farm Loan Board, any Federal Land Bank may establish branches within the land bank district.

§ 233. **Capital of Land Banks.**—Every Federal Land Bank shall have, before beginning business, a subscribed capital of not less than $750,000. The Federal Farm Loan Board is authorized to prescribe the times and conditions of the payment of subscriptions to capital stock, to reject any subscription in its discretion, and to require subscribers to furnish adequate security for the payment thereof.

The capital stock of each Federal Land Bank shall be divided into shares of $5 each, and may be subscribed for and held by any individual, firm, or corporation, or by the Government of any State or of the United States.

§ 234. **Farm Loan Associations.**—Corporations, to be known as national farm loan associations, may be organized by persons desiring to borrow money on farm mortgage security under the terms of this Act. Such persons shall enter into articles of association which shall specify in general terms the object for which the association is formed and the territory within which its operations are to be carried

on, and which may contain any other provision, not inconsistent with law, which the association may see fit to adopt for the regulation of its business and the conduct of its affairs.

Ten or more natural persons who are the owners, or about to become the owners, of farm land qualified as security for a mortgage loan under this Act, may unite to form a national farm loan association. They shall organize subject to the requirements and the conditions in this Act, so far as the same may be applicable: Provided, That the board of directors may consist of five members only, and instead of a secretary and a treasurer there shall be a secretary-treasurer, who need not be a shareholder of the association.

§ 235. **How Loans Are Made.**—When the articles of association are forwarded to the Federal Land Bank of the district, they shall be accompanied by the written report of the loan committee, and by an affidavit stating that each of the subscribers is the owner, or is about to become the owner, of farm land qualified under this Act as the basis of a mortgage loan; that the loan desired by each person is not more than $10,000, nor less than $100, and that the aggregate of the desired loans is less than $20,000; that said affidavit is accompanied by a subscription to stock in the Federal Land Bank equal to five per centum of the aggregate sum desired on mortgage loans; and that a temporary organization of said association has been formed by the election of a board of directors, a loan committee, and a secretary-treasurer who subscribes to said affidavit, giving his residence and post office address.

Upon receipt of its charter such national farm loan association shall be authorized and empowered to receive from the Federal Land Bank of the district sums to be loaned to its members under the terms and conditions of this Act. (Loans are only made after appraisal of the land offered as security, by one of the land bank appraisers provided for by another section of this Act).

§ 236. Powers of Farm Loan Associations.—Every national farm loan association shall have power:

First. To indorse, and thereby become liable for the payment of, mortgages taken from its shareholders by the Federal Land Bank of its district.

Second. To receive from the Federal Land Bank of its district funds advanced by said land bank, and to deliver said funds to its shareholders on receipt of first mortgages qualified under section twelve of this Act.

Third. To acquire and dispose of such property, real or personal, as may be necessary or convenient for the transaction of its business.

Fourth. To issue certificates against deposits of current funds bearing interest for not longer than one year at not to exceed four per centum per annum after six days from date, convertible into farm loan bonds when presented at the Federal Land Bank of the district in the amount of $25 or any multiple thereof. Such deposits, when received, shall be forthwith transmitted to said bank, and be invested by it in the purchase of farm loan bonds issued by a

Federal Land Bank or in first mortgages as defined by this Act.

§ 237. **Restrictions on Loans.**—No Federal Land Bank organized under this Act shall make loans except upon the following terms and conditions:

First. Said loans shall be secured by duly recorded first mortgages on farm land within the land bank district in which the bank is situated.

Second. Every such mortgage shall contain an agreement providing for the repayment of the loan on an amortization plan by means of a fixed number of annual or semiannual installments sufficient to cover, first, a charge on the loan, at a rate not exceeding the interest rate in the last series of farm loan bonds issued by the land bank making the loan; second, a charge for administration and profits at a rate not exceeding one per centum per annum on the unpaid principal, said two rates combined constituting the interest rate on the mortgage; and, third, such amounts to be applied on the principal as will extinguish the debt within an agreed period, not less than five years nor more than forty years: Provided, That after five years from the date upon which a loan is made additional payments in sums of $25 or any multiple thereof for the reduction of the principal, or the payment of the entire principal, may be made on any regular installment date under the rules and regulations of the Federal Farm Loan Board: And provided further, That before the first issue of farm loan bonds by any land bank the interest rate on mortgages may be determined in the discretion of said land bank subject to the provisions and limitations of this Act.

Third. No loan on mortgage shall be made under this Act at a rate of interest exceeding six per centum per annum, exclusive of amortization payments.

Fourth. Such loans may be made for the following purposes and for no other:

(a) To provide for the purchase of land for agricultural uses.

(b) To provide for the purchase of equipment, fertilizers and live stock necessary for the proper and reasonable operation of the mortgaged farm; the term "equipment" to be defined by the Federal Farm Loan Board.

(c) To provide buildings and for the improvement of farm lands; the term "improvement" to be defined by the Federal Farm Loan Board.

(d) To liquidate indebtedness of the owner of the land mortgaged, existing at the time of the organization of the first national farm loan association established in or for the county in which the land mortgaged is situated, or indebtedness subsequently incurred for purposes mentioned in this section.

Fifth. No such loan shall exceed fifty per centum of the value of the land mortgaged and twenty per centum of the value of the permanent, insured improvements thereon, said value to be ascertained by appraisal, as provided in this Act. In making said appraisal the value of the land for agricultural purposes shall be the basis of appraisal and the earning power of said land shall be a principal factor.

A reappraisal may be permitted at any time in the discretion of the Federal Land Bank, and such additional loan may be granted as such reappraisal

will warrant under the provisions of this paragraph. Whenever the amount of the loan applied for exceeds the amount that may be loaned under the appraisal as herein limited, such loan may be granted to the amount permitted under the terms of this paragraph without requiring a new application or appraisal.

Sixth. No such loan shall be made to any person who is not at the time, or shortly to become, engaged in the cultivation of the farm mortgaged. In case of the sale of the mortgaged land, the Federal Land Bank may permit said mortgage and the stock interests of the vendor to be assumed by the purchaser. In case of the death of the mortgagor, his heir or heirs, or his legal representative or representatives, shall have the option, within sixty days of such death, to assume the mortgage and stock interests of the deceased.

Seventh. The amount of loans to any one borrower shall in no case exceed a maximum of $10,000, nor shall any loan be for a less sum than $100.

§ 238. **Agents of Federal Land Banks.**—Whenever, after this Act shall have been in effect one year, it shall appear to the Federal Farm Loan Board that national farm loan associations have not been formed, and are not likely to be formed, in any locality, because of peculiar local conditions, said board may, in its discretion, authorize Federal Land Banks to make loans on farm lands through agents approved by said board.

Such loans shall be subject to the same conditions and restrictions as if the same were made through national farm loan associations, and each borrower

shall contribute five per centum of the amount of his loan to the capital of the Federal Land Bank, and shall become the owner of as much capital stock of the land bank as such contribution shall warrant.

No agent other than a duly incorporated bank, trust company, mortgage company, or savings institution, chartered by the State in which it has its principal office, shall be employed under the provisions of this section.

§ **239. Joint Stock Land Banks.**—In addition to the system of twelve Federal Land Banks and the national farm loan associations of borrowers, the act permits the establishment of joint stock land banks and authorizes them to carry on the business of lending directly to borrowers on farm mortgage security and issuing farm loan bonds. These banks must have a capital of not less than $250,000. They are under the supervision of the federal farm loan board, but the government does not lend them any financial assistance.

The joint stock land bank is free from many of the conditions imposed on the Federal Land Banks. Subject to the 50 and 20 per cent value limitation and the limitation as to territory, the joint stock land bank may lend more than $10,000 to a single individual and it is not restricted to making loans for the purposes specified in the case of the Federal Land Bank.

The joint stock bank, like the Federal Land Banks, cannot charge an interest rate on farm mortgages in excess of 6 per cent, nor shall such interest rate exceed by more than 1 per cent the rate of interest

paid by the bank upon its last issue of bonds. A joint stock bank is limited in its bond issue to fifteen times its capital and surplus.

Among the restrictions placed on these banks under the act are (1) that their mortgages must provide for an amortization system of repayment such as is prescribed in the case of loans through the Federal Land Banks, and (2) that they shall in no case demand or receive under any form or pretense any commission or charge not specifically authorized by the act and approved by the farm loan board.

The bonds of the joint stock land banks are exempted from taxation. Their capital stock, however, is not exempted.

§ 240. **General Provisions.**—The law, through the Farm Loan Board, provides the necessary machinery for frequent examinations of the banks and the associations, for the proper cancellation of mortgages and for the safe custody of mortgages offered as security for bonds. When any mortgage offered as security for bonds is withdrawn the bank is required to replace the security with other mortgages or with other satisfactory collateral.

Heavy penalties of fine or imprisonment, or both, are imposed for violations of the act, malfeasance in office, fraud, embezzlement, defalcation, or other illegal practices.

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§ 241. **What is Amortization?**—The Federal Farm Loan Act is a law the intention of which is to make it possible for the farmers to make money by borrowing money. Its intention is to place money

within reach of the farmer on such terms as to convert the farm mortgage into a source of profit.

The law requires that the Federal Farm Loan Board "shall prepare and publish amortization tables which shall be used by national farm loan associations and land banks organized under this act." In many other parts of the law this word "amortization" is used.

Now, what is amortization, and what is there in it for the farmer? The word "amortization" is a cousin of a number of other words in the English language. When a wound or a disease brings death we call it "mortal." Human beings are said to be "children of mortality," because all men must die. Insurance companies use what are called "mortality" tables, which show the percentages of certain classes of people to die within certain periods of time. All these words are derived from the Latin word "mors," which means "death." To "amortize" a mortgage, therefore, is to put it to death. The "amortization" of a mortgage means, literally, killing off the mortgage. Almost every farmer, therefore, must be interested in any system based upon the principle, first, of making it possible for farmers to get into debt on an economical and even a profitable basis, and at the same time of killing the mortgage off, or getting out of debt by amortization.

§ 242. **An Easy Plan for Farmers.**—Only one kind of a mortgage loan is permitted under the Federal Farm Loan Act, and that is one which is killed off, put to death, or amortized during the time for which the loan is made. This would make it very hard for the farmer if he were obliged to pay his

debt in three or five years, which are the terms under which most farm loans have been made in the past. It is easy to see that a farmer, who borrows a thousand dollars on five years' time must pay nearly two hundred dollars a year on the principal besides taking care of the interest, if he pays it off during the time for which the money is borrowed. In the vast majority of cases it is about all he can do to pay the interest and a very small amount, perhaps, on the principal. The result has been that he has been obliged to renew the loan at the end of the three years' or five years' time. In many instances the renewal of the loan has been difficult, and he has been worried and troubled by the necessity of getting the loan renewed; he has frequently had to pay commissions and agents' fees for the renewal, and in most instances has been obliged to have his title examined again, and has, in fact, been put to a good deal of expense and trouble. When these renewals have had to be made in times of financial stringency, the farmer has sometimes lost his farm because he could not get his loan renewed.

All these conditions are changed for farmers who take out loans under the Federal Farm Loan Act. He may take out the loan under this act for as short a time as five years, but so far no farmer in the United States has borrowed under the Federal Farm Loan Act for as short a time as five years. He does not need to. No matter how long a time he may select for the running of his loan, he has the right to pay off, after five years, on any interest date, in sums as low as $25. So that, even though he may borrow for 40 years, his loan is absolutely under his control, so far as payment is concerned, after the lapse of five

years. If he has the money idle and can not find any better use for it he may pay off his mortgage and clean the whole thing up. If he is not able to save the money, or if he can find some better use for the money, he does not need to pay up except as required to amortize or kill off the mortgage.

This gives to farmers borrowing under the Federal Farm Loan Act the easiest farm-mortgage plan ever known to the American farmer.

§ 243. **Example.**—Suppose you are a farmer and wish to borrow $3,000 on the security of your land. You borrow it by joining a national farm loan association in the manner described in the act. You get your $3,000 in cash. In order to get it you have to furnish evidence of your title, and your land must be appraised. You take it on 35 years' time. This does not mean that the loan runs for 35 years and then fall due. These amortized loans "mature" in 35 years, but they never fall due. They are amortized or killed off by small payments every year. The payments may be either every six months or every year, and the first payment is exactly the same as the payment made at the end of the thirty-fourth year. The last payment may not be exactly the same size as the other payments, but it is about the same.

In your case you would pay 5½ per cent interest on your $3,000, which is $165 a year. This is the regular interest. You would amortize the loan or kill it off by paying another 1 per cent of $3,000, or $30 to the $165 interest, making $195. By paying this sum, $195, annually for 35 years you not only will carry interest on the debt, but you will completely pay it off, amortize it, extinguish it.

§ 244. What Amortization Does For Farmers.—In the past the lender has had control of the matter of payment. The borrower has been, in the scriptural sense, "the servant to the lender." Amortization changes all that. The borrower, for the first time, is given the chance to say what he wants. When he borrows through a Federal Land Bank, the land bank will not tell him he can have the money for only one year, or three years, or five years, but the farmer will tell the bank how long he wishes the mortgage to run. He can pay the mortgage off only after the lapse of five years, but the history of farm mortgages shows that when a farm is once mortgaged it usually stays mortgaged. For the benefit of the farmer, therefore, it is much better to have the debt under the control of the borrower than under the control of the lender. Amortization works wonders for the farmer who is in debt. It relieves his mind, for the fear of foreclosure no longer haunts him. It lightens the drain on his purse, for it reduces the interest he has to pay. Most of the farm loans in the United States, up to 1919, were drawing interest at about 8 per cent, some of them as high as 12 per cent and 15 per cent and only a few of them in number were made at a rate as low as 5½ per cent net. The Federal farm loan rate all over the United States is 5½ per cent flat, and everything the farmer pays above that is an amortization charge, and cuts down or kills off the mortgage.

§ 245. Making Additional Payments.—The Federal Farm Loan Act gives the farmer the privilege of paying any amount he wishes, from $25 up, to be applied on the principal of his loan after the lapse of

five years, on the date of any payment called for by his contract. Where such payments are made it changes all the subsequent payments on the loan, and the amortization table for that loan is no longer a guide as to the condition of the loan. To figure out exactly the amount due on a loan which has run 15 or 20 years, and been decreased by one or more extra payments of this sort, is easy for those who are familiar with the system, but would be a rather complicated problem for the average man.

§ 246. **Benefits of Amortization.**—Any farmer however, can see at once that an amortized loan is very much better for him than the old-fashioned mortgage. Under an amortized loan he pays off gradually because he is obliged to do so, and the whole loan never falls due. He is never obliged to go through the worry, trouble, and expense of renewing the whole of a mortgage and perhaps being asked by the lender to reduce it by paying a sum larger than he can raise. The principal benefit, however, seems to lie in the saving of interest. If a straight mortgage loan of $1,000 was carried 35 years at 5½ per cent the borrower would pay $1,925 in interest. That is, he would make 35 interest payments of $55 each and he would still owe his whole debt of $1,000. But the interest tables furnished to the borrower show that if he carries his amortized loan of $1,000 at 5½ per cent through for the 35 years without any extra payments, the interest is only $1,272.50. It is only the first interest payment on this loan which is exactly a $55 payment. All interest payments after the first are less than $55 each. The second year the interest payment is $54.45. The third year

it is $53.87, and at the thirty-fifth year the interest payment is only $3.26. All this time the payments on the principal are increasing, year by year, as the interest payments grow smaller. The average interest payment on this loan is $36.36 a year, or an average interest rate of about 3 2/3 per cent a year. To be sure, he pays 5½ per cent interest on every cent which he owes during the entire life of the loan, but the amount which he owes is made less and less every year by the application of a part of his payments to the discharge of the principal.

§ 247. **Loans by Land Banks.**—On October 31, 1919, the twelve Federal Land Banks had assets amounting to $315, 442,000. Their mortgage loans amounted to $271,317,816. The total paid-in capital was $21,894,256.50, of which $8,256,809 was owned by the government, $13,536,782.50 by national farm loan associations, $47,235 by individual subscribers and $44,430 by borrowers through agents. There were 3,989 farm loan associations on the date named. The number and amount of loans approved in each federal land bank district were:

District	Number	Amount
1. Springfield, Mass.	3,771	$10,433,445
2. Baltimore, Md.	4,288	10,928,300
3. Columbia, S. C.	6,804	14,442,495
4. Louisville, Ky.	6,505	18,900,100
5. New Orleans, La.	12,769	18,667,930
6. St. Louis, Mo.	9,374	21,596,280
7. St. Paul, Minn.	13,206	35,383,000
8. Omaha, Neb.	7,171	36,131,690
9. Wichita, Kans.	10,111	23,961,900
10. Houston, Tex.	10,643	29,999,156
11. Berkeley, Cal.	4,686	14,578,900
12. Spokane, Wash.	14,344	36,294,620
Total	103,672	271,317,816

The net earnings of these banks to October 31, 1919,

were $1,278,000, from which in addition to a reserve of $202,175, dividends were paid to the amount of $332,923, leaving the net undivided profits on hand $743,295.

§ 248. **Joint Stock Land Banks.**—Twenty-five joint stock land banks had been organized and were doing business October 31, 1919. The aggregate assets of the twenty-five banks on that date amounted to $62,917,000, the principal items being mortgaged loans, amounting to $48,092,000, United States bonds and other securities $8,486,000, cash on hand and in banks $3,415,000. The capital of these joint banks was $7,812,050, surplus $151,415, reserve $35,231.

Questions for Review, Chapter X.

1. What is the primary purpose of the Federal Land Bank system?
2. How is the Farm Loan Act administered? By what body, and how is it constituted?
3. How is the country divided for the purposes of the Act?
4. What is the capital of the Farm Loan banks, and how is it derived?
5. How are Farm Loan Associations organized, and by whom?
6. What are the powers of Farm Loan Associations?
7. How and to whom may loans be made by Farm Loan banks?
8. How are farm loans secured under the Act? What restrictions are provided?
9. What is the nature of the Joint Stock Loan banks provided for in the Act?
10. What is the meaning of "amortization"?
11. In what way does this system benefit the farmer who carries a loan?
12. Give an example of the working of the amortization plan.

CHAPTER XI

The Comptroller's Office

Section 249. Supervision of Banks.—The office of the Comptroller of the Currency, heretofore referred to, was created by an act of Congress passed in 1863. The duties defined by the statute were that he should have the supervision of banks to be organized throughout the country, known as "national banks." These banks were compelled to deposit with the Treasury department United States bonds to be held as security for their circulating notes, thus providing a sound bank currency and at the same time creating a market for bonds.

It was the intention of those who created the act that the office should be kept out of politics. It was created for a distinct business purpose, having a close relation to the commercial and financial interest of the country, and the situation required that the Comptroller should be free from all political bias, and that the office should remain outside the realm of politics. So far as the Comptrollers of the Currency have been concerned, they have, as best they could within their power, kept the office out of politics and made it distinctly a business office.

In accordance with this idea, the incumbent of the office was to be appointed by the President of the

United States upon the suggestion of the Secretary of the Treasury, and to hold the office for a period of five years, thus extending it beyond the incumbency of the presidential office. The Comptroller could not be removed from office except on charges filed by the President, and action taken thereon in the form of impeachment—the only office, with possibly the exception of the Director of the Mint, where removal cannot be had on charges filed with the Senate.

§ 250. **An Independent Office.**—There is a nominal affiliation between the Treasury department and the office of the Comptroller of the Currency, but the Comptroller's office, differing from any other connected with the department, does not report on what goes on within the Comptroller's office, either to the Treasurer or to the President; nor does the Comptroller report either to the President or the Secretary, but he reports directly to the Congress of the United States, being required to give annually the conditions of the banks as they are on a certain day prior to the convening of Congress, together with such recommendations as would, in his opinion, improve the banking conditions of the country. The salary of the office, like that attaching to most high positions under the government, is very meager, being only $5,000 a year; and yet there are a good many people willing to accept the place.

The act creating the national bank system and the office of Comptroller sets forth what shall be done to create a national bank. It gives the number of persons who may take a charter (not less than five), and fixes the minimum amount of capital for such

banks, that being not less than $50,000 in cities of not over 6,000 inhabitants, and from $100,000 to $2,000,000 in cities of larger size. This act has been amended to permit the organization of banks with $25,000 capital, and in other respects.

§ 251. **Organization Department.**—The office in its organization has three or four departments. The Organization Department receives the application for the creation of a national bank. The application must set forth the names of those who are seeking the charter, the amount of capital, the population of the city, etc. When the application is received, the Comptroller examines it to ascertain whether or not the persons applying should be granted a charter; and if, in his judgment, a charter should not be given, it is not granted. This is not the result of any statutory requirement but a course which the office has assumed of itself without any question as to its right. The great powers of which the incumbent of the office is possessed are powers which he has assumed rather than received by legislative enactment, and their assumption and continued possession come largely from the fact that the banking institutions over which he presides realize the importance of the Comptroller's hands being upheld, if the banks are to be healthful and sound institutions.

The bank, having been granted a charter, is given a name, that which the incorporators select always being given, unless at that time or prior the name suggested has been used by another bank. The bank, having then deposited with the Treasurer of the United States the minimum amount of bonds, may

now take out circulation. There have been a good many banks, especially in the larger cities requiring a minimum amount of $50,000 bonds, which have never taken out any circulation whatever. There are few banks that have the maximum amount of circulation which the law permits them. This is on the principle that there is not any profit in the circulation, and that it is better to leave the bonds without taking out the circulation, paying the tax, and going to the general trouble of having the circulation issued.

§ 252. National Bank Examiners.—After the bank has been established, it comes under the active supervision of the Comptroller of the Currency. Under the act he is empowered, subject to the approval of the Secretary of the Treasury (and in that alone has the Secretary any control over the Comptroller's office, exercising the same right that the Senate of the United States does over the appointments of the President of the United States), to appoint a number of men to the office of National Bank Examiners. Their duties, under the direction of the Comptroller of the Currency, are to visit the banks in the districts to which they are appointed.

Here again comes into play the power assumed on the part of the Comptroller, for he makes it the duty of the examiner, not only to see that the capital stock is intact but to see further that all the methods of banking employed in the bank are of a character that insures not only safety to the public, but benefit to the stockholder. As a result, the examiner not only sees that all the cash is there, but he takes upon himself the duty of seeing to it, as far

as he can, that the paper held by the bank is genuine, that the notes are of the value that they represent themselves to be, and that many other details are properly administered.

Thus it happens that when an inspector comes into a bank and finds an old-fashioned method of bookkeeping employed, he reports that fact; he also ascertains the salary of the various officials, the amount of rent paid, and all other details which enter into the conduct of a bank. The same method of examination is pursued whether in the National City Bank of New York, with a capital of $25,000,000, or in the smallest bank of medium capital.

The great strength of the national bank system, the great source of its influence over the banking system of the country since its establishment, has arisen from the very uniformity of the control exercised in the Comptroller's office, bringing about in the individual banks, whether in Chicago, New York or elsewhere, the same method of bookkeeping and the same details which are necessary to the careful management of a bank.

§ 253. **Department of Reports.**—The examiner's report is made to the Comptroller of the Currency, and thence sent to the Department of Reports, where there is a large force of clerks to examine these reports, see what is defective in the bank, and compare with the previous report. Upon the basis of these reports the Comptroller of the Currency writes to the president or directors of the bank suggesting steps to be taken to strengthen the position of the bank.

§ 254. **Redemption Department.**—There is another division of the Comptroller's office known as the Redemption Department, where mutilated and worn-out bank notes and the notes of banks which have gone into liquidation are redeemed.

§ 255. **Issuing Department.**—Another department, known as the Issuing Department, issues to the banks the amount of bank notes to which they are entitled. Until the Bank Act was amended during the administration of President McKinley, the amounts of circulating notes to be issued on the deposit of bonds was 90 per cent of the par value of the bonds. But under the present act, the total value of the bonds may be issued upon the 2 per cent bonds which were the refunding bonds of the former administration.

As to whether a bond-secured circulation is a wise circulation there are a good many suggestions. Safety does not enter into the question so long as the bonds of the United States continue good; which will be as long as United States revenues are collected; as long as the people are able to pay internal-revenue taxes or duties on imported goods. It has been suggested that the method of issuing bank-note currency is not desirable, because it gives to the creditor of the bank who is a note-holder an advantage over the creditor who is simply a depositor, in making the former preferred over the latter. Under the existing bond system the note-holder is a preferred creditor, because before the bank gets started into active operation so many of its assets are taken in the shape of bonds and deposited with the Treasurer of the United States to secure bank

notes, these bonds being sold in case of failure of the bank, and the amount received from the sale being used to pay the claim of the preferred creditor, who holds the notes of the bank. In case there is not a sufficient amount of money received from the bonds to pay the notes, the act provides that the note-holder shall have a prior lien on the other assets of the bank, out of which he shall be reimbursed before the payment is made to depositors.

Another objection which has always been found has not arisen from the idea that the safety could be improved, but is that with a note circulation amounting to only 90 per cent, or even to par on the deposited bonds, the premium on the bonds over their par value is always tied up. When the banks were allowed circulation equal to 90 per cent of the par value of the bonds and the bond was selling at 100 to 115, there was always twenty-five dollars locked up, not available for loaning; and even at present there is still eleven dollars taken out of the actual channels of the business and permitted to lie in Washington, a source of profit neither to the bank nor to Congress.

So there are some very valid objections to the provisions for issuing notes by the banks, and a former Comptroller said on this point, "As we make progress in the field of finance we shall come to understand what is the proper basis for a bank-note circulation, and shall not be surprised if the bank-note issue shrinks to nothing, because it is more profitable to sell the bonds than to hold them as a basis for note issue. When a bank-note currency is based upon a security which varies in market value, no matter what may be the monetary needs of the country, if

there is more profit in selling the bonds than in taking out notes thereon, the bonds will be sold."

§ 256. **Insolvent Banks.**—If the bank impairs its capital, the Comptroller of the Currency notifies the directors and calls upon them to make good the deficit. In case they fail to do so, the Comptroller declares the bank insolvent and places it in the hands of a receiver. In this the Comptroller is fortified by the decisions of the Supreme Court of the United States. His judgment must control. When he declares that a bank is insolvent, there is no power in the courts of the United States to gain say that, and he is clothed with the power to appoint a receiver to take charge of the assets.

There was, for instance, the case of a bank in Tacoma which an examiner reported as having only a reserve of 6 per cent whereas the requirement was 15 per cent, as it was in all but five or six large cities, known as reserve cities, where twenty-five per cent was required. The Comptroller ordered the examiner to declare the bank insolvent. The directors got out an injunction, but the judge declared that, while he thought it was all wrong for the Comptroller of the Currency to have more power than the President and Congress, he could not do anything but let him take charge of the bank if he so desired. This power vested in the Comptroller requires impartial action over all banks that come under his control.

§ 257. **Responsibility of the Office.**—The office differs from any other office in Washington because there is absolutely no routine. Every case is an individual case, and the Comptroller must exercise in-

dividual judgment in every instance The great responsibility that attaches to the office is due to the fact that the bank is the only necessity in every community that affects every business enterprise. The failure of the bank takes out of the business channels of the community more or less of the funds, and curtails the credit of the community.

That was particularly so during the panic of 1893. During the thirty years of the existence of the office prior to that time there had been 182 failures of national banks. During the first two weeks of the incumbency of James H. Eckels as Comptroller there were 165 failures. The result of the failure of so many banks was seriously to embarrass many communities, and the effect was very far-reaching. He concluded to give a bank opportunity to do business if he found its management sound and honest. It would be assumed that a bank having failed once, and having suspicion attached to it, could never succeed in obtaining the confidence of the public. Mr. Eckels tried the experiment, laying down certain conditions which were to be complied with on the part of the directors of the bank. Of the 165 that failed he thus opened 115, and 100 of these proved to be very successful institutions.

There were many banks that did not fail, but were close to the point, and the question with the Comptroller was whether to close them at once or run the risk of their failure with ensuing disaster to the community. There was one instance where he considered for a long time the advisability of closing a prominent bank in the Northwest. The institution had enjoyed high credit, but, because of investing in notes based

on land booms in the neighborhood, the credit was seriously impaired. The examiner insisted that the bank should be closed, but the Comptroller felt that he should take the risk. However, he put on it an assessment of considerable size. Many of the stockholders came to see him, and they finally concluded to pay the assessment, and that bank is now the largest in its State.

§ 258. **Liquidation of Assets.**—As a result of bad banking or mistaken banking, banks are very likely to get themselves loaded up with assets not easily realizable, and when the pinch comes they fail and go into the hands of a receiver. The liquidation of these assets is not an easy problem, especially as the law requires that the receiver shall recommend what shall be done with this or that asset, that the Comptroller shall approve, and that the district court shall enter a decree authorizing the sale.

While it is provided that the bank shall not loan upon real estate, a good many banks get such security by making a loan and then taking additional security in the form of a mortgage. In the failure of banks a good deal of such paper is found. There are many assets of a strange character. At one time the Comptroller had a full equipment for an opera house; he had in a Dakota town a butcher shop; he had any amount of live stock, one trotting horse, which sold for $10,000. In Puget Sound a certain bank had as a part of its assets enough cans to can a large portion of the salmon caught in the Columbia river. And there is hardly a thing you could name, from an article of wearing apparel to a large manufactory, that

at some time or other does not in this way get into the hands of the Comptroller.

Questions for Review, Chapter XI.

1. What are the general duties of the Comptroller of the Currency?

2. What provisions were made in the Act of 1863 for keeping the office of Comptroller out of politics?

3. Does the affiliation of the office with the Treasury Department prevent its independence?

4. What are the functions of the organization department in the Comptroller's office?

5. What are the functions of the redemption department?

6. What is the function of the issuing department?

7. What must be set forth in the application for the creation of a national bank?

8. Are the great powers of the Comptroller derived from legislative enactment?

9. How are the national bank examiners appointed?

10. What are the duties of the examiners?

11. To whom do the bank examiners report?

12. What objections have been urged to the method of issuing bank note currency?

13. What is the course taken by the Comptroller if a bank impairs its capital?

14. In what respect does the office of the Comptroller differ from any other in Washington?

15. What responsibility falls upon the Comptroller with respect to the liquidation of the bank's assets?

CHAPTER XII

Monetary System of the U. S.

Section 259. Gold and Silver Coinage.—In 1786 the Congress of the Confederation chose as the monetary unit of the United States the dollar of 375.64 grains of pure silver. This unit had its origin in the Spanish piaster or milled dollar, which constituted the basis of the metallic circulation of the English colonies in America. It was never coined, there being at that time no mint in the United States.

The act of April 2, 1792, established the first monetary system of the United States. The bases of the system were: The gold dollar or unit, containing 24.75 grains of pure gold, and stamped in pieces of \$10, \$5, and \$2½, denominated respectively eagles, half eagles, and quarter eagles; the silver dollar or unit, containing 371.25 grains of pure silver. A mint was established. The coinage was unlimited, and there was no mint charge. The ratio of gold to silver in coinage was 1 to 15. Both gold and silver were legal tender. The standard was double.

The act of 1792 undervalued gold, which was therefore exported. The act of June 28, 1834, was passed to remedy this, by changing the mint ratio between the metals to 1 to 16.002. This latter act fixed the weight of the gold dollar at 25.8 grains, but lowered

the fineness from 0.916 2/3 to 0.899225. The fine weight of the gold dollar was thus reduced to 23.2 grains. The act of 1834 undervalued silver, as that of 1792 had undervalued gold, and silver was attracted to Europe by the more favorable ratio of 1 to 15½. The act of January 18, 1837, was passed to make the fineness of the gold and silver coins uniform. The legal weight of the gold dollar was fixed at 25.8 grains and its fine weight at 23.22 grains. The fineness was therefore changed by this act to 0.900 and the ratio to 1 to 15.988.

Silver continued to be exported. The act of February 21, 1853, reduced the weight of the silver coins of denominations of less than $1, which the acts of 1792 and 1837 had made exactly proportional to the weight of the silver dollar, and provided that they should be legal tender to the amount of only $5. Under the acts of 1792 and 1837 they had been full legal tender. By the act of 1853 the legal weight of the half-dollar was reduced to 192 grains and that of the other fractions of a dollar in proportion. The coinage of the fractional parts of the dollar was reserved to the Government.

§ 260. **Provisions of the Act of 1873.**—The act of February 12, 1873, provided that the unit of value of the United States should be the gold dollar of the standard weight of 25.8 grains, and that there should be coined, besides, the following gold coins: A quarter eagle, or 2½ dollar piece; a three-dollar piece; a half-eagle or 5 dollar piece; an eagle, or ten-dollar piece, and a double eagle, or 20-dollar piece, all of a standard weight proportional to that of the dollar piece. These coins were made legal tender in all

payments at their nominal value when not below the standard weight and limit of tolerance provided in the act for the single piece, and when reduced in weight they should be legal tender at a valuation in proportion to their actual weight. The silver coins provided for by the act were a trade dollar, a half dollar, or 50-cent piece; a quarter dollar, and a 10 cent piece; the weight of the trade dollar to be 420 grains troy; the half-dollar 12½ grams; the quarter dollar and the dime, respectively, one-half and one-fifth the weight of the half dollar. These silver coins were made legal tender at their nominal value for any amount not exceeding $5 in any one payment. The charge for converting standard gold bullion into coin was fixed at one-fifth of 1 per cent. Owners of silver bullion were allowed to deposit it in any mint of the United States, to be formed into bars or into trade dollars, and no deposit of silver for other coinage was to be received.

Section 2 of the joint resolution of Congress of July 22, 1876, recited that the trade dollar should not thereafter be legal tender, and that the Secretary of the Treasury should be authorized to limit the coinage of the same to an amount sufficient to meet the export demand for it. The act of February 19, 1887, retired the trade dollar and prohibited its coinage. That of September 26, 1890, discontinued the coinage of the one-dollar and 3-dollar gold pieces.

§ 261. **The Silver Act of 1878.**—The act of February 28, 1878, directed the coinage of silver dollars of the weight of 412½ grains troy, of standard silver as provided in the act of January 18, 1837, and that such coins, with all standard silver dollars there-

tofore coined, should be legal tender at their nominal value for all debts and dues, public and private, except where otherwise expressly stipulated in the contract.

The Secretary of the Treasury was authorized and directed by the first section of the act to purchase from time to time silver bullion at the market price thereof, not less than $2,000,000 worth nor more than $4,000,000 worth per month, and to cause the same to be coined monthly, as fast as purchased, into such dollars. A subsequent act, that of July 14, 1890, directed that the Secretary of the Treasury should purchase silver bullion to the aggregate amount of 4,500,000 ounces, or so much thereof as might be offered, each month, at the market price thereof, not exceeding $1 for 371.25 grains of pure silver, and to issue in payment thereof Treasury notes of the United States, such notes to be redeemable by the Government, on demand in coin, and to be legal tender in payment of all debts, public and private except where otherwise expressly stipulated in the contract.

The act directed the Secretary of the Treasury to coin each month 2,000,000 ounces of the silver bullion purchased under the provisions of the act into standard silver dollars until the first day of July, 1891, and thereafter as much as might be necessary to provide for the redemption of the Treasury notes issued under the act. The purchasing clause of the act of July 14, 1890, was repealed by the act of November 1, 1893.

§ 262. **The Standard of Value.**—In providing for the coinage of the precious metals Congress estab-

lished, by the act of April 2, 1792, the standard of value, consisting of certain gold and silver coins, at a ratio of 15 to 1—that is to say, the value of an ounce of fine gold was in effect declared to be equal to the value of fifteen ounces of fine silver.

A list of the coins authorized by the act of April 2, 1792, with the weights and fineness, will be found on a following page. Both gold and silver coins were declared to be standards.

The ratio of 15 to 1 was adopted in pursuance of investigations conducted by Alexander Hamilton, Secretary of the Treasury, who, in his report upon the subject, said that 15 to 1 was a near approximation of the commercial value of the two metals. It was soon discovered, however, that gold at the ratio of 15 to 1 was undervalued, and silver became practically the only metallic money available for use in the United States. In 1834 the ratio was changed to 16.002 to 1, and in 1837 it was changed to 15.988 to 1. That is the present ratio and is commonly called 16 to 1. By this change silver was undervalued and gold came into use in its place.

By the act of February 12, 1873, the coinage of the standard silver dollar was discontinued, and the gold dollar of 25.8, grains of standard gold, .900 fine, was declared to be the unit of value. The subsequent restoration of the coinage of silver dollars under the act of February 28, 1878, was on Government account, and did not restore the silver dollar to its former place as a standard of value.

But while Congress provided for the so-called double or bimetallic standard, such double standard has

never been effective in the United States. From 1792 to 1834 silver was the metal by which all values were measured, and since 1834 gold has been and still is the sole actual standard.

§ 263. **Coins and Paper Currency.**—There are twelve different kinds of money in circulation in the United States, namely, gold coins, standard silver dollars, subsidiary silver, gold certificates, silver certificates, Treasury notes issued under the act of July 14, 1890, United States notes (also called greenbacks and legal tenders), national bank notes, federal reserve notes, federal reserve bank notes, and nickel and bronze coins. These forms of money are all available as circulation. While they do not all possess the full legal-tender quality, each kind has such attributes as to give it currency. The status of each kind is as follows:

Gold coin is legal tender at its nominal or face value for all debts, public and private, when not below the standard weight and limit of tolerance prescribed by law; and when below such standard and limit of tolerance it is legal tender in proportion to its weight.

Standard silver dollars are legal tender at their nominal or face value in payment of all debts, public and private, without regard to the amount, except where otherwise expressly stipulated in the contract.

Subsidiary silver is legal tender for amounts not exceeding $10 in any one payment.

Treasury notes of the act of July 14, 1890, are legal tender for all debts, public and private, except

where otherwise expressly stipulated in the contract.

Federal reserve notes and Federal reserve bank notes—see Chapter IX.

United States notes are legal tender for all debts, public and private, except duties on imports and interest on the public debt.

(United States notes, upon resumption of specie payments, January 1, 1879, became acceptable in payment of duties on imports and have been freely received on that account since the above date.)

Gold certificates, silver certificates, and national bank notes are not legal tender, but both classes of certificates are receivable for all public dues, while national bank notes are receivable for all public dues except duties on imports, and may be paid out by the Government for all salaries and other debts and demands owing by the United States to individuals, corporations, and associations within the United States, except interest on the public debt and in redemption of the national currency. All national banks are required by law to receive the notes of other national banks at par.

The minor coins of nickel and copper are legal tender to the extent of 25 cents.

§ **264. Gold Coins.**—The coinage of legal-tender gold was authorized by the first coinage act passed by Congress, April 2, 1792.

The gold unit of value is the dollar, which contains 25.8 grains of standard gold .900 fine. The amount of fine gold in the dollar is 23.22 grains, and the remainder of the weight is an alloy of copper.

While the gold dollar is the unit and standard of value, the actual coinage of the $1 piece was discontinued under authority of the act of September 26, 1890. Gold is now coined in denominations of $2.50, $5, $10, and $20, called respectively, quarter eagles, half eagles, eagles, and double eagles.

The total coinage of gold by the mints of the United States from 1792 to June 30, 1919, was $3,410,407,527, of which it was estimated that about half was in existence as coin in the United States, while the remainder represented the excess of exports over imports and the amount consumed in the arts.

The basis for the estimate of the amount of gold coin in the United States was established in 1873, when the amount in the vaults of the national banks and in the Treasury was ascertained from reports to be $71,188,548. To this was added $20,000,000 as an estimate of the amount of gold in use on the Pacific coast, $10,000,000 as the amount held by all other banks and by the people and $3,818,086 in national banks. The amount thus ascertained was $105,006,634, to which have been added each year the new coinage reported by the Director of the Mint and the imports as shown by the custom house reports, and from which have been deducted the exports and the amounts consumed in the arts. It will be seen that one-half of the gold coins struck at the mints of the United States have disappeared from circulation.

§ 265. **Silver Coins.**—The principal silver coin is the dollar, which contains 412½ grains of standard silver .900 fine. The amount of fine silver in the dollar is 371¼ grains, and there are 41¼ grains of cop-

per alloy. The standard silver dollar was first authorized by the act of April 2, 1792. Its weight was 416 grains .8924 fine. It contained the same quantity of fine silver as the present dollar, whose weight and fineness were established by the act of January 18, 1837. The coinage of the standard silver dollar was discontinued by the act of February 12, 1873, and it was restored by the act of February 28, 1878. The total amount coined from 1792 to 1873 was $8,031,238, and the amount coined from 1878 to December 31, 1904, when the coinage was discontinued, was $570,272,610. The coinage ratio between gold and silver under the act of 1792 was 15 to 1, but by the acts of 1834 and 1837 it was changed first to 16.002 to 1 and finally to 15.988 to 1 (commonly called 16 to 1). This is the present ratio.

§ 266. **Subsidiary Silver.**—The silver coins of smaller denominations than one dollar, authorized by the act of April 2, 1792, were half dollars, quarter dollars, dimes, and half dimes. They were the equivalent in value of the fractional parts of a dollar which they represented—that is, two half-dollars were equal in weight to one silver dollar, and so on. These coins were full legal tender when of standard weight, and those of less than full weight were legal tender at values proportional to their respective weights.

By the act of February 21, 1853, the weight of the fractional silver coins was reduced so that the half dollar weighed only 192 grains, and all the smaller denominations were reduced in proportion. Their legal-tender quality was at the same time limited to $5, and they thus became subsidiary coins. The

present subsidiary coins are half dollars, quarter dollars, and dimes. Their weight is slightly different from that prescribed by the act of 1853; but the limit of their legal-tender quality has been raised to $10.

There was a period, from 1862 to 1876, when there was no fractional silver coin in circulation in the United States except on the Pacific coast. During this period the small change of the country consisted of fractional paper currency, which is described below.

§ 267. **Issue of Silver Dollars and Subsidiary Silver.**—Standard silver dollars are issued by the Treasurer and assistant treasurers in redemption of silver certificates and Treasury notes of 1890, and are sent by express, at the expense of the Government, in sums or multiples of $500, for silver certificates or Treasury notes deposited with the Treasurer or any assistant treasurer.

Upon the deposit of an equivalent sum in United States currency or national bank notes with the Treasurer or any assistant treasurer or national bank depositary, subsidiary silver coin will be paid in any amount by the Treasurer or assistant treasurers in the cities where their several offices are, or will be sent by express, in sums of $200 or more, at the expense of the Government, or by registered mail, at the risk of the consignee, in packages of $50, registration free, from the most convenient Treasury office, to the order of the depositor. For this purpose drafts may be sent to the Treasurer or the assistant treasurer in New York, payable in their respective cities to the order of the officer to whom sent.

§ 268. The Silver Act of 1890.

An Act Directing the purchase of silver bullion and the issue of Treasury notes thereon, and for other purposes. (Public—No. 214. 1890.)

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Secretary of the Treasury is hereby directed to purchase, from time to time, silver bullion to the aggregate amount of four million, five hundred thousand ounces, or so much thereof as may be offered in each month, at the market price thereof, not exceeding one dollar for three hundred and seventy-one and twenty-five hundredths grains of pure silver, and to issue in payment for such purchases of silver bullion Treasury notes of the United States to be prepared by the Secretary of the Treasury, in such form and of such denominations, not less than one dollar nor more than one thousand dollars, as he may prescribe; and a sum sufficient to carry into effect the provisions of this act is hereby appropriated, out of any money in the Treasury not otherwise appropriated.

Sec. 2. That the Treasury notes issued in accordance with the provisions of this act shall be redeemable on demand, in coin, at the Treasury of the United States, or at the office of any assistant treasurer of the United States, and when so redeemed may be reissued, but no greater or less amount of such notes shall be outstanding at any time than the cost of the silver bullion and the standard silver dollars coined therefrom, then held in the Treasury purchased by such notes and such Treasury notes shall be a legal tender in payment of all debts, public and private, except where otherwise expressly stipulated in the contract, and shall be receivable for customs, taxes, and all public dues, and when so received may be reissued; and such notes, when held by any national banking association, may be counted as a part of its lawful reserve. That upon demand of the holder of any of the Treasury notes herein provided for the Secretary of the Treasury shall, under such regulations as he may prescribe, redeem such notes in gold or silver coin, at his discretion, it being the established policy of the United States to maintain the two metals on a parity with each other upon

the present legal ratio, or such ratio as may be provided by law.

Sec. 3. That the Secretary of the Treasury shall each month coin two million ounces of the silver bullion purchased under the provisions of this act into standard silver dollars until the first day of July, eighteen hundred and ninety-one, and after that time he shall coin of the silver bullion purchased under the provisions of this act as much as may be necessary to provide for the redemption of the Treasury notes herein provided for, and any gain or seigniorage arising from such coinage shall be accounted for and paid into the Treasury.

* * * *

§ 269. **Meaning of 16 to 1.**—The phrase "16 to 1," as applied to coinage, means that the mint value of 16 ounces of silver shall be equal to the mint value of 1 ounce of gold, that is, that 16 ounces of silver shall be coinable into as many standard silver dollars as one ounce of gold is coinable into standard gold dollars.

§ 270. **Standard Bullion.**—Standard bullion contains 900 parts of pure gold or pure silver and 100 parts of copper alloy.

The coining value of an ounce of pure gold is $20.-67183 and the coining value of an ounce of standard gold is $18.60465.

The coining value in standard silver dollars of an ounce of pure silver is $1.2929 and the coining value of an ounce of standard silver is $1.1636.

§ 271. **What Is Seigniorage?**—The term seigniorage, as used in the United States, means the profit arising from the coining of bullion. The Government does not purchase gold bullion, but coins it on private account. There is no profit from the coinage

of gold bullion, the face value of gold coins being the same as their bullion value, but at the present ratio of 16 to 1 the face value of the silver dollar may be greater than its bullion value; therefore when silver bullion is purchased and coined into dollars there is a profit arising from such coinage, the amount of which depends upon the price paid for the bullion. For example, there are 371¼ grains of pure silver in a dollar and there are 480 grains of pure silver in a fine ounce. The coinage value of a fine ounce is, therefore, $1.2929. If the fine ounce can be purchased for 70 cents, the profit of its coinage (the seigniorage) is $0.5929—, and the profit on the 371¼ grains of pure silver in the single dollar is $0.4586—, which is the difference between the actual cost of the bullion in the dollar and the nominal value of the coin.

The silver purchased by the Government is carried on the books of the Treasury at its actual cost, and the seigniorage is declared on the coinage of each month and paid into the Treasury.

§ 272. **Coinage of Gold.**—In the United States there is free and unlimited coinage of gold, that is, standard gold bullion may be deposited at the mints in any amount, to be coined for the benefit of the depositor, without charge for coinage; but when other than standard bullion is received for coinage a charge is made for parting, or for refining, or for copper alloy, as the case may be. Refining is the elimination from the bullion of all base metals. Parting is the separation of any silver which may be contained in the bullion. The charges for these operations vary according to the actual expenses. When copper is added for alloy, a charge of 2 cents per

ounce is made for the amount actually added. The depositor receives in gold coin the full value of the gold in his bullion, less such charges as are indicated above.

The mints may lawfully refuse to receive gold bullion of less value than $100, or when it is too base for coinage; but in practice deposits of gold bullion are accepted without regard to amounts, and rejected only when too base for coinage.

§ 273. **Coinage of Silver.**—Under existing law in the United States subsidiary silver is coined only on Government account. This coinage is made from bullion purchased by the Government under the provisions of section 3526, Revised Statutes, and the profits on such coinage belong to the Government.

The total amount of silver bullion purchased under the act of July 14, 1890, from August 13, 1890, the date the act went into effect, to November 1, 1893, the date of the repeal of the purchasing clause of that act, was 168,674,682.53 fine ounces of silver costing $155,931,002.25.

There were coined from the bullion purchased under the act of July 14, 1890, 187,027,345 standard silver dollars, of which $134,285,166 represent the cost of the bullion coined, and which was held in the Treasury for the redemption of Treasury notes of 1890, while the remainder $52,742,179, constitute the gain or seigniorage, and being the property of the United States, was paid into the Treasury of the United States to be used as other available funds.

Under the acts of March 14, 1900, and March 2, 1903, there were coined to July 1, 1905, from the

silver bullion purchased under the act of July 14, 1890, $33,118,576 in subsidiary silver coin, of which $21,583,300 represent the cost of the bullion contained in such coinage and for which an equal amount of Treasury notes of 1890 were retired, and the balance, $11,535,276, seigniorage paid into the Treasury.

The seigniorage is an addition to the volume of money in the country, while the silver coin representing the cost of the bullion is not, since it is paid out only in redemption of the Treasury notes of 1890, whereupon the latter are canceled and retired, as prescribed by the acts of July 14, 1890, and March 14, 1900.

The total expenditure by the United States for silver bullion exclusive of subsidiary silver coinage, is:

Under act of February 28, 1878	$308,297,260.71
Under act of July 14, 1890	155,931,002.00
Total	$464,210,262.71

There have been coined from the bullion thus purchased standard silver dollars of the face value of $570,272,610, and subsidiary silver coin of the face value of $33,118,576, consuming the entire amount of bullion purchased under the act of July 14, 1890.

§ 274. **Trade Dollars.**—The trade dollar of 420 grains troy was authorized by the act of February 12, 1873. It was intended for circulation in oriental countries as a substitute for the Mexican dollar, which it slightly exceeded in weight; but by the

terms of the authorizing act it was made legal tender in the United States in sums not exceeding $5.

This legal tender quality was withdrawn by the joint resolution approved July 22, 1876, and the coinage was limited to such amount as the Secretary of the Treasury should consider sufficient to meet the export demand. The act of February 19, 1887, provided for the retirement of trade dollars and their recoinage into standard silver dollars or subsidiary silver. For six months after the passage of the act they could be exchanged at the Treasury or any subtreasury, dollar for dollar, for standard silver dollars or subsidiary coin.

The total number of trade dollars coined was 35,965,924. The number redeemed under the act of 1887 was 7,689,036, and from the bullion resulting from the melting of these dollars there were coined in subsidiary silver $2,668,674.30, and into standard silver $5,078,472. Since the expiration of the period of redemption above mentioned, trade dollars have been purchased as bullion when presented at the mints

§ **275. Free and Unlimited Coinage of Silver.**—This term, as used in the discussion of the coinage question, means the right of any person to deposit standard silver bullion in any amount at the mints of the United States and have it coined at the expense of the Government, such depositor to receive for his bullion silver coins containing in the aggregate the same weight of fine silver as brought to the mint.

§ **276. Unlimited Coinage.**—Coinage may be unlimited without being entirely free. It would be unlimited if any owner of bullion had the right to de-

posit it at the mint and have it converted into coins without any restrictions as to the amount.

§ 277. **Sales of Gold.**—During the period of the suspension of specie payments in the United States —January 1, 1862, to January 1, 1879—the customs revenues of the Government were collected in gold. A sufficient amount of this gold was reserved to meet that portion of the interest on the public debt which was payable in coin, and the remainder was sold from time to time for currency at the market price by the several assistant treasurers of the United States, under instructions from the Secretary of the Treasury. The currency so obtained, with the currency collected from internal revenue and from other sources, was used to defray the ordinary expenses of the Government. The surplus, if any, was applied, as far as it would go, to the redemption of the lawful-money obligations as they fell due, and after their maturity to the purchase of bonds at the market price.

The total amount of gold sold was $526,506,273.81, and the currency received therefor amounted to $633,334,089.67. The average premium obtained was 20.3 per cent.

§ 278. **Redemption of Currency.**—Gold coins and standard silver dollars, being standard coins of the United States, are not "redeemable."

Subsidiary coins and minor coins may be presented, in sums or multiples of $20, to the Treasurer of the United States or to an assistant treasurer for redemption, or exchange into lawful money.

United States notes are redeemable in United

States gold coin in any amount by the Treasurer and and all the assistant treasurers of the United States.

Treasury notes of 1890 are redeemable in United States gold coin in any amount by the Treaasurer and all the assistant treasurers of the United States.

National bank notes are redeemable in lawful money of the United States by the Treasurer, but not by the assistant treasurers. They are also redeemable at the bank of issue. In order to provide for the redemption of its notes when presented every national bank is required by law to keep on deposit with the Treasurer a sum equal to 5 per cent of its circulation.

Gold certificates being receipts for gold coin, are redeemable in such coin by the Treasurer and all assistant treasurers of the United States.

Silver certificates are receipts for standard silver dollars deposited, and are redeemable in such dollars only.

"Coin" obligation of the Government are redeemed in gold coin when gold is demanded and in silver when silver is demanded.

§ 279. Foreign Coins Not Legal Tender.—Section 3584 of the Revised Statutes of the United States provides that no foreign coins shall be a legal tender in the United States.

§ 280. Denominations, Weight and Fineness of the Coins of the United States.

GOLD.

Denomination	Fine gold contained Grains	Alloy contained* Grains	Weight Grains
One dollar ($1)	23.22	2.58	25.80

Quarter eagle ($2.50)	58.05	6.45	64.50
Three dollars ($3)	69.66	7.74	77.40
Half eagle ($5)	116.10	12.90	129.00
Eagle ($10)	232.20	25.80	258.00
Double eagle ($20)	464.40	51.60	516.00

*The alloy neither adds to nor detracts from the value of the coin.

SILVER.

Denomination	Fine silver contained Grains	Alloy contained Grains	Weight Grains
Standard dollar	371.25	41.25	412.50
Half dollar	173.61	19.29	192.90
Quarter dollar	86.805	9.645	96.45
Dime	34.722	3.858	38.58

Prior to the act of February 21, 1853, all silver coins were legal tender in all payments whatsoever. The act of February 21, 1853, reduced the weight of all silver coins of less denomination than the silver dollar about 7 per cent, to be coined on Government account only, and made them legal tender in payment of debts for all sums not exceeding $5.

MINOR.

Denomination	Fine copper contained Grains	Alloy contained Grains	Weight Grains
Five cents*	57.87	19.29	77.16
One cent†	45.60	2.40	48.

*Seventy-five per cent copper, 25 per cent nickel.

†Ninety-five per cent copper, 5 per cent tin and zinc.

Troy weights are used, and while metric weights are by law assigned to the half and quarter dollar and dime, troy weights still continue to be employed, 15,432 grains being considered as the equivalent of a gram, agreeably to the act of July 28, 1866.

The weight of $1,000 in United States gold coin is 53.75 troy ounces, equivalent to 3.68 pounds avoirdupois. The weight of $1,000 in standard silver dollars is 859.375 troy ounces, equivalent to 58.92 pounds

avoirdupois, and the weight of $1,000 in subsidiary silver is 803.75 troy ounces, equivalent to 55.11 pounds avoirdupois.

§ 281. **Paper Money.**—The first paper money ever issued by the Government of the United States was authorized by the acts of July 17 and August 5, 1861. The notes issued were called "demand notes," because they were payable on demand at certain designated subtreasuries. They were receivable for all public dues, and the Secretary was authorized to reissue them when received, but the time within which such reissues might be made was limited to December 31, 1862. The amount authorized by these acts was $50,000,000. An additional issue of $10,000,000 was authorized by the act of February 12, 1862, and there were reissues amounting to $30,000. The demand notes were paid in gold when presented for redemption and they were received for all public dues, and these two qualities prevented their depreciation. All other United States notes depreciated in value from 1862 until the resumption of specie payments.

The act of February 25, 1862, provided for the substitution of United States notes in place of the demand notes, and the latter were therefore canceled when received. By July 1, 1863, all except $3,770,000 had been retired, and nearly three millions of this small remainder were canceled during the next year. These notes were not legal tender when first issued, but they were afterwards made so by the act of March 17, 1862.

§ 282. **United States Notes.**—The principal issue of United States paper money was officially called

United States notes. These were the well-known "greenbacks" or "legal tenders." The act of February 25, 1862, authorized the issue of $150,000,000, of which $50,000,000 were in lieu of an equal amount of demand notes, and could be issued only as the demand notes were canceled. A second issue of $150,000,000 was authorized by the act of July 11, 1862, of which, however, $50,000,000 was to be a temporary issue for the redemption of a debt known as the temporary loan. A third issue of $150,000,000 was authorized by the act of March 3, 1863. The total amount authorized, including the temporary issue, was $450,000,000, and the highest amount outstanding at any time was $449,338,902 on January 30, 1864.

The reduction from the original permanent issue of $400,000,000 to $346,681,016 was caused as follows: The act of April 12, 1866, provided that United States notes might be retired to the extent of $10,000,000 during the ensuing six months, and that thereafter they might be retired at the rate of not more than $4,000,000 per month. This authority remained in force until it was suspended by the act of February 4, 1868. The authorized amount of reduction during this period was about $70,000,000, but the actual reduction was only about $44,000,000. No change was made in the volume of United States notes outstanding until after the panic of 1873, when, in response to popular demand, the Government reissued $26,000,000 of the canceled notes.

This brought the amount outstanding to $382,000,000, and it so remained until the resumption act of January 14, 1875, provided for its reduction to $300,-

000,000. The process was, however, again stopped by the act of May 31, 1878, which required the notes to be reissued when redeemed. At that time the amount outstanding was $346,681,016, which is the present amount. The volume outstanding is undiminished because of the provisions of the act of May 31, 1878, which require the notes so redeemed to be paid out again and kept in circulation.

The act of March 14, 1900, also directed the reissue of United States notes when redeemed, but they must first be exchanged for gold as provided in the said act. The act also provides that when silver certificates of large denominations are canceled, and small denominations issued in their place, a like volume of small United States notes shall from time to time be canceled and notes of $10 and upward issued in substitution therefor.

§ 283. **Gold Certificates.**—The act of March 3, 1863, authorized the Secretary of the Treasury to receive deposits of gold coin and bullion in sums not less than $20, and to issue certificates therefor in denominations not less than $20, said certificates to be receivable for duties on imports. Under this act deposits of gold were received and certificates issued until January 1, 1879, when the practice was discontinued by order of the Secretary of the Treasury. The purpose of the order was to prevent the holders of United States notes from presenting them for redemption in gold, and re-depositing the gold in exchange for gold certificates. No certificates were issued after January 1, 1879, until the passage of the bank act of July 12, 1882, which authorized and directed the Secretary of the Treasury

to receive gold coin and bullion and issue certificates.

This act, however, provided that "the Secretary of the Treasury shall suspend the issue of gold certificates whenever the amount of gold coin and gold bullion in the Treasury, reserved for the redemption of United States notes, falls below one hundred million of dollars." The act of March 14, 1900, reenacted this provision, and further provided that the Secretary may, in his discretion, suspend such issue whenever and so long as the aggregate amount of United States notes and silver certificates in the general fund of the Treasury shall exceed $60,000,000. It provided further that of the amount of such certificates outstanding one-fourth, at least, shall be in denominations of $50 or less. The act of July 12, 1882, made them receivable for customs, taxes, and all public dues.

§ 284. **Silver Certificates.**—The act of February 28, 1878, authorizing the issue of the standard silver dollars, provided that any holder of such dollars might deposit them in sums not less than $10 with the Treasurer or any assistant treasurer of the United States and receive certificates therefor, in denominations not less than $10, said certificates to be receivable for customs, taxes, and all public dues. The act of August 4, 1886, authorized the issue of the smaller denominations of $1, $2, and $5. Silver certificates have practically taken the place in circulation of the standard silver dollars which they represent. The act of March 14, 1900, provided that thereafter the issue of silver certificates should be limited to the denominations of $10 and under, except that 10 per cent of the total volume of such certifi-

cates, in the discretion of the Secretary of the Treasury, may be issued in denominations of $20, $50, and $100. Neither silver certificates nor silver dollars are redeemed in gold.

§ 285. **Treasury Notes, Act of July 14, 1890.**—These notes were authorized by the act of July 14, 1890, commonly called the "Sherman Act." The Secretary of the Treasury was directed to purchase each month 4,500,000 ounces of fine silver at the market price, and to pay for the same with Treasury notes redeemable on demand in coin and legal tender for all debts, public and private, except where otherwise expressly stipulated in the contract. It was provided in the act that when the notes should be redeemed or received for dues they might be reissued, but that no greater or less amount of such notes should be "outstanding at any time than the cost of the silver bullion and the standard silver dollars coined therefrom, then held in the Treasury purchased by such notes."

The authority for the purchase of silver bullion under this act was repealed by the act of November 1, 1893, up to which date the Government had purchased 168,674,682.53 fine ounces, at a cost of $155,-931,002, for which Treasury notes were issued. Treasury notes redeemed in standard silver dollars are canceled and retired in accordance with the requirements of the act of 1890. Sections 5 and 8 of the act of March 14, 1900, also provide for the cancellation and retirement of Treasury notes to an amount equal to the coinage of standard silver dollars and subsidiary silver from the bullion purchased with such notes.

§ 286. **Fractional Currency.**—When specie payments were suspended, about January 1, 1862, both gold and silver coins disappeared from circulation. The place of the subsidiary silver coins was for a time supplied by the use of tickets, due bills, and other forms of private obligations, which were issued by merchants, manufacturers, and others whose business required them to "make change." Congress soon interfered, and authorized, first, the use of postage stamps for change; second, a modified form of postage stamp called postal currency, and finally, fractional paper currency in denominations corresponding to the subsidiary silver coins. The highest amount authorized was $50,000,000. The highest amount outstanding at any time was $49,102,660.27, and the amount still outstanding, though not in use as money, is $15,245,183.88, of which $8,375,934 is officially estimated to have been destroyed.

§ 287. **National Bank Currency.**—The issue of circulating notes by national banking associations was first authorized by an act entitled "An act to provide a national currency secured by a pledge of United States stock, and to provide for the circulation and redemption thereof," approved February 25, 1863, which act was repealed by an act entitled "An act to provide a national currency secured by a pledge of United States bonds, and to provide for the circulation and redemption thereof," approved June 3, 1864. The act approved June 3, 1864, with subsequent amendments thereof, was embodied in the Revised Statutes of the United States in 1873. The law as embodied in the Revised Statutes has been amended from time to time, and is now con-

tained in what is known as the national bank act, with amendments thereof.

Material amendments have been made to the national bank act during the past few years. The first, dated March 14, 1900, authorized the formation of national banks with minimum capital of $25,000; the issue of circulation to the par value of bonds deposited, and reduced the tax on circulation secured by 2 per cent bonds to one-fourth of 1 per cent semi-annually.

The act of June 22, 1906, authorized national banks to loan to one interest an amount not in excess of 10 per cent of the paid-in capital stock and surplus, the aggregate, however, not to exceed 30 per cent of the capital, the original limitation being 10 per cent of the capital stock.

On January 26, 1907, an act was approved prohibiting national banks or other corporations organized by authority of any act of Congress from making money contributions in connection with political elections.

At the following session of Congress the banking law was further amended authorizing the organization of national currency associations and the issue to bank members of such associations of additional circulation on securities including commercial paper held by the national banking associations. The act further authorized the deposit with the Treasurer of the United States, in trust, of State, municipal, etc., bonds, as security for circulation, but provided that additional circulation can only be issued to banks having an unimpaired capital, and surplus equal to 20 per cent of the capital, and whose circula-

tion secured by United States bonds amounts to at least 40 per cent of their capital stock. Additional circulation however, can only be issued at such times and under such conditions as, in the judgment of the Secretary of the Treasury, an increase in national bank circulation is warranted.

See chapter IX, on the Federal Reserve System as it applies to bank circulation.

§ 288. **Security.**—Under the provisions of existing law a national bank is required to deposit interest-bearing bonds or notes of the United States with the United States Treasurer as security for its circulating notes in the following minimum amounts:

(a) Banks with a capital not exceeding $150,000 must deposit bonds, par value, to an amount not less than one-fourth of their capital stock.

(b) Banks with a capital exceeding $150,000 must deposit bonds to the amount of at least $50,000, par value.

Circulating notes are issued against United States bonds deposited as security therefor to the par value of the bonds or of the market value, if the bonds are below par, the maximum amount issuable on bonds being measured by the paid-in-capital stock.

§ 289. **Profits on Circulation.**—Tables published annually by the Comptroller of the Currency show the profit arising from a bank investing its funds in bonds and taking out circulation thereon, compared with the profits from investment of the same funds at 6 per cent per annum. This profit varies with the cost of the bonds and the rates of interest current where a bank is located.

Questions for Review, Chapter XII.

1. What were the bases of the first monetary system of the United States, established under the Act of April 2, 1792?

2. What coinage was provided for under the Act of Congress of 1873?

3. To what amount are the subsidiary silver coins of the United States legal tender?

4. To what amount are nickel and copper coin legal tender?

5. Why was the ratio of 15 to 1 adopted by Congress and when was it changed?

6. Has the so-called double or bimetallic standard ever been really effective in the United States?

7. How many different kinds of money circulate in the United States?

8. Under what conditions is gold coin legal tender for all debts, public and private?

9. Are gold certificates, silver certificates, and national bank notes receivable for all public dues?

10. What is the weight and fineness of the gold unit of value?

11. In what denominations is gold now coined and what are the coins called respectively?

12. How are standard silver dollars issued by the treasurer and assistant treasurers of the United States?

13. What were the provisions of the Silver Act of 1890?

14. What is the meaning of the phrase 16 to 1 as applied to coinage?

15. What is the meaning of free and unlimited coinage of gold as existing in the United States?

16. What is the meaning of the free and unlimited coinage of silver?

17. What was the nature of the first paper money ever issued by the government of the United States?

18. When were the well-known "greenbacks" or "legal tenders" issued, and in what quantity?

19. When were gold certificates first issued and when was the practice temporarily discontinued?

20. What do the silver certificates represent?

21. Are silver certificates and silver dollars redeemable in gold?

22. What were the provisions of the so-called Sherman Act of 1890 with regard to the issue of Treasury notes?

23. When was the issue of circulating notes by national banking associations first authorized?

24. What is the security required from banks for their circulating notes?

CHAPTER XIII

Foreign Exchange

Note:—This chapter and the one which follows, on the same general subject, are from the pen of an acknowledged authority on Foreign Exchange, Mr. H. K. Brooks, former manager of the Western Financial department of the American Express Company and author of a comprehensive textbook on the subject. A few changes from the original text have been made, in consequence of the conditions brought about by the World War, but the matter retains its full value for study by those who desire authoritative information on this branch of the banking business.—Editor.

Section 290. A Branch of Banking.—While foreign-exchange transactions are generally regarded as being quite complicated, and there are some operations requiring experience and patient study, the system as a whole cannot be said to be any more intricate than many of the problems daily arising in mercantile business.

Comparatively few persons have a thorough knowledge of the subject and this may perhaps be attributed to the fact that until recent years the business was confined to the leading banks at large trade centers. Other banks having call for foreign drafts, letters of credit, or other foreign paper would obtain the same from the large banks mentioned or refer customers to them direct.

The enormous growth of our import business, the large increase in foreign travel, and the extension of

our trade to nearly every country in the world so greatly increased the volume of foreign exchange transactions that it naturally invited competition, and today almost every bank and financial institution at a place of any importance is equipped with the facilities necessary to meet the demand for this class of business of its patrons.

§ 291. Foreign Departments Supersede Brokers.—American merchants who formerly imported goods from foreign countries through brokers at seaport cities now have foreign departments for the transaction of the business direct. Our manufacturers, who formerly did not think of looking beyond the limits of this country for a market for their goods, have learned, through a better knowledge of the conditions, that they can successfully compete with foreign manufacturers. Our war with Spain is said to have opened the eyes of our manufacturers to the fact that there was a vast population outside of the United States who were dependent for many commodities upon countries which were in no better position, geographically or otherwise, to supply their needs; and if we judge from the large increase in our exports since that war, there was, no doubt, some foundation for the statement. The World War still further opened our eyes.

§ 292. Opportunity for Students.—In an article published in one of the leading financial papers of New York it was stated recently that the demand among bankers and large mercantile houses for young men having a general knowledge of foreign exchange and foreign shipping very greatly exceeds the supply; that students fitting themselves for mer-

cantile life should devote as much study as possible to this branch, since it would be a very valuable acquisition to their fitness for the present commercial business, and at the same time insure a higher appreciation and greater salary for their services than is usually paid for other branches of either mercantile or banking business.

§ 293. **What Foreign Exchange Is.**—Foreign exchange is a system by which commercial nations discharge their debts to each other. This indebtedness may represent the value of commodities exported to or imported from other countries, money borrowed, loaned, or invested abroad, and the interest profits on such funds; the cost for transportation of goods and the commissions for service; the expense incurred in traveling in foreign countries; in fact, any transactions which involve the remitting of money, or anything representing money, from one country to another. These debts have to be paid either with cash or something equally satisfactory to the creditors. The cost of transmitting gold or currency, and the risk attending the same, while sometimes resorted to, are generally considered too great, and it is to avoid this risk and expense that the system of exchanging debts through the medium of commercial paper is adopted.

§ 294. **Magnitude of Foreign Trade.**—One can hardly appreciate the magnitude of the business between the United States and foreign countries which, directly or indirectly, is transacted through the medium of the system we term "foreign exchange," without resorting to actual data in the

shape of figures, and we find these figures so large as to be almost incomprehensible.

For the twelve months ending June 30, 1920, the value of the goods or commodities exported from this country to other countries amounted to $8,111,039,733, and during the same period the United States imported from other countries goods to the value of $5,238,621,668 making a total of exports and imports during the fiscal year 1920 of $13,349,661,401.

The value of the goods we exported exceeded the value of those imported by $2,872,418,065, which amount of credit in our favor would, had there been no other transactions to offset it, have to be remitted to us from the various foreign countries. But against this credit in our favor foreign countries charged up to us the amount paid out on letters of credit used by our people to meet expenses in travel abroad—balance due on loans made by our capitalists to float large enterprises, such as railroad consolidations, etc., so that, notwithstanding there was a large balance due us in the difference between the value of the goods we sold to, and those we purchased from foreign countries, it was offset by other transactions, so that in fact, during the year 1920 we exported more gold than we imported. But whether the balance be in our favor or against us, the total amount of the business transacted is practically all handled through the medium of the system we call "foreign exchange," and the importance of a thorough knowledge of the system in its various details is becoming greater each year.

§ 295. **Knowledge of Monetary Systems.**—A

knowledge of the moneys of account, or monetary systems, of the various foreign countries is one of the first things necessary to a clear understanding of foreign exchange transactions.

Paper moneys, such as government and bank notes and certificates, are, as a rule, intended solely for circulation within the country in which issued, and are not legal tender outside of the country from which they emanate. Of course, paper money is often accepted in small amounts for its full face value in other countries, but it is always optional with the creditor to accept it.

Silver and minor coins are also intended for domestic use, and when accepted in other countries it is at their actual intrinsic value rather than at their face value. For illustration: The purchasing power of the silver dollar of the United States within this country is as great for small sums as that of the gold dollar, but in other countries it would be accepted only for its bullion value.

§ 296. **The Only International Money.**—Gold, by virtue of commercial usage and the laws of the various countries of the world, may be said to be the only international money, and its purchasing power is practically the same all over the civilized world. But it must be remembered that the value of gold coins is not always as expressed on their face. In large international transactions the weight of the mass is regarded, and not the number of pieces, and their value depends upon the weight and fineness. By "fineness" is meant pure metal. Nearly all coins contain alloy, or inferior metal which is added to increase their durability.

The value or price of the gold money of account of commercial countries is determined by the weight and fineness of the metal contained therein, which weight and fineness are established by the mint laws of the country issuing the money. It is therefore essential that the standard of weight by which the various moneys of account are established shall be unvarying and have the highest legal sanction; otherwise there could be no stability of values and no such thing as accurate deductions of par of exchange. Gold is the only commodity in the world the value of which is established by law.

The price of gold cannot be affected either by an abundance or scarcity of the supply. No matter how large the supply, our mints, or the Bank of England, will buy it at the price established by law; and although there is no international agreement to maintain the price, the fact that gold is accepted by the chief commercial nations as the one universal measure of value, operates to prevent any attempt to change its valuation. The price of diamonds, which are more valuable than gold, is affected by the supply and demand. Silver, used extensively as money, fluctuates in price like any commodity, the supply and demand governing its value.

§ 297. **How Gold Shipments Are Handled.**—As gold shipments between the United States and foreign countries, particularly Europe, are an important factor in foreign-exchange transactions, it is well to learn how they are handled and the expense attending them.

Whether in coined pieces or bars (bullion), the gold is packed in strong kegs or boxes, securely strapped

with hoop iron, and carefully sealed with private seals; the latter to discover if tampered with en route. Space is chartered from the steamship company, as in the case of merchandise, although nearly all large fast steamers have rooms especially constructed for such valuable cargo. At a cost of 3/16 of 1 per cent, or $1,875 for each million dollars in value, the shipper has the gold insured against loss. The steamship company charges for carrying the shipment as freight a rate of about 1/8 per cent of its value, or about $1,250 for each million dollars. As an extra safeguard in case of large shipments, the steamship company details special armed men to guard the room day and night, and sometimes the shipper employs special detectives in citizen's clothes to watch the passengers on the trip, since it is generally known several days in advance when large shipments of gold are to be made.

§ 298. **Commercial Bars of Gold.**—In accordance with the United States Mint regulations, a charge of four cents per $100 is made for what are known as commercial bars of gold, which are from 990 to 997 thousandths fine. The shipper has to pay for these bars with gold coin, which is obtained without charge at the Subtreasury in exchange for gold certificates or for legal tender notes. There is no restriction upon the withdrawals of gold from the Subtreasury for export, and the shipper has the option of taking coined pieces, if he prefers, but the loss by abrasion of coined pieces practically equals the cost of 4 cents per $100 charged by the mint for commercial bars, which are put up in that shape to induce exporters to take bars instead of coined pieces, and thus save

the government the cost of coinage as well as the transportation of the bullion to the mint.

§ 299. **"Money of Account."**—It is not necessary to recall here the names and denominations of all the coins or money used in the various foreign countries. The money of account of the principal countries has been already noted (in chapter VI). By "money of account" we mean the kind of money in which the people keep their accounts, as, for example, we keep our accounts in dollars and cents.

§ 300. **The British System.**—Foremost among all foreign nations in the magnitude of its commerce, its vast colonial possessions and dependencies, and consequently its importance as a leading financial center, Great Britain furnishes the most interesting study of the money of the world. Every school child can tell you the money of account of Great Britain. To us it seems a complicated, cumbersome system. The pound sterling is equal to 20 shillings, each shilling being equal to 12 pence, and each penny equal to 4 farthings. Without exception the sovereign is the most universally recognized coin, and, except the Egyptian pound, it is the largest of all units of money. Its normal (ante-bellum) value in our money is about $4.87.

§ 301. **"Sterling" Exchange.**—Probably more foreign exchange is drawn in sterling—here and in other countries as well—than in the money of all other countries combined. This is due, however, to the fact that London has long been the financial center of the world, and exchange on that city is generally acceptable, if not preferred. For the same reason prob-

ably 90 per cent of all letters of credit issued throughout the world are drawn in English money.

The term "rate of exchange" means the value or the price of the money of one country reckoned in the money of any other country, the value being a fixed rate of exchange, the price a fluctuating rate of exchange.

The rate of exchange quoted between any two countries is for drafts, checks, or bills of exchange, and the price includes, besides the actual equivalent of the standard coin, some allowance for interest according to the tenor of the draft, and a premium which the seller demands for the economy and superior convenience of his drafts or check as compared with a remittance in currency or bullion. This premium, which represents the fluctuation, is more or less according to the amount of exchange in the market for sale and the demand for the same.

§ 302. **Two Kinds of Exchange.**—There are two kinds of exchange—direct and arbitrated. Direct is when between any two countries; arbitrated, when between two places in different countries through the medium of some other place in another country; or, to express it more clearly, the remitting of money to one country through another country, or the buying of exchange of one country through another.

The occasion for the arbitration of exchange will arise when the rate of exchange here direct upon a country to which you wish to remit is much higher than between that country and another near by.

For illustration: Through the financial columns of our daily papers, or by tabled information direct,

the rate for a check in London on Paris or Berlin, or vice versa, is furnished. Prior to the World War it generally read, for example, this way: "Exchange on Paris F. 25.12; exchange on Berlin M. 20.42." This signified that you could buy in London, for instance, a check payable in Paris at the rate of 25 francs 12 centimes per pound sterling, or on Berlin at the rate of 20 marks 42 pfennig per pound sterling. Therefore, if you had occasion to remit a large sum to, say, Berlin, and you found you could buy a check on London and have the amount remitted from London to Berlin cheaper than you could remit to Berlin direct, the transaction would be termed "arbitration of exchange." All large banking houses and jobbers of foreign exchange watch the quotations on exchange between countries very closely, and always avail themselves of any advantage to be gained by remitting to one country through another.

§ 303. **The Rate of Exchange.**—The fluctuation in the price of exchange, or, as it is termed, "the rate of exchange," is due to a number of causes. If the value of the goods we exported greatly exceeded the value of the goods we imported during a certain period, the large balance due us from other countries would, if there were no other international transactions to offset them, cause the price of exchange here to be lower, for the reason that there would be less demand for remittance to foreign countries, since it is always the difference between the debits and credits that is remitted. On the other hand, if we owed foreign countries a much greater amount than they owed us, exchange here would be higher by reason of increased demand for it.

But it is not alone our foreign commercial trade that regulates the price of exchange. The monetary conditions here and abroad may entirely offset other conditions, as we have seen since 1914.

When the loaning rate for money here is high, capitalists and bankers will loan their money here, instead of investing in foreign commercial bills, which causes less demand for bills, hence lower rates. If rates for money abroad are high, there will be a greater demand for commercial bills or other exchange on foreign countries, for the purpose of getting their money to those countries to take advantage of such high rates, thereby causing higher rates. If the rates for money abroad are lower than here, our capitalists and bankers would borrow money in their markets for investment here, thus increasing our indebtedness to foreign countries, and when such loans became due there would be an increased demand for exchange to pay these, resulting in higher rates.

§ 304. Effect of Discount Rates.—The discount rates at London, Paris, Berlin, and other European centers very materially affect the buying and selling price for commercial bills drawn against commodities exported. These discount rates are the rate per cent at which commercial paper of the different classes may be discounted—that is, the allowance made for cashing or taking up the paper before maturity or before due and payable. These discount rates fluctuate according to the conditions prevailing, as does the rate of exchange. When discount rates abroad are high, the rates for commercial bills here will be lower, and when low abroad, the rate for commercial bills here will be higher.

Under normal conditions, the rates for foreign exchange fluctuate between what are termed gold-exporting or gold-importing points, which means the actual cost of the gold plus the cost of transporting it from one point to another.

For example: If you wished to remit, say, to London the equivalent of £50,000, and you found that the cost of the gold coin or bullion and the expense of freight, insurance, commissions, etc., would be considerably less than the cost of a draft or check for the amount on London, then you would ship gold in preference. If the cost were equal or greater for shipping gold, then you would remit by check, as it would be more convenient and less risk. Therefore the rates naturally do not go much above or much below the gold points.

When the rate for demand sterling exchange got down to, say, \$4.83¾ to \$4.84 per pound, it was formerly cheaper to import gold. If such exchange reaches as high as \$4.84¼ to \$4.88½ per pound, then gold could be exported equally cheaply.

But notwithstanding these various conditions which affect the market price for foreign exchange, it is the supply and demand that regulate the price, as in the case of wheat, corn, or any commodity.

§ 305. **Par of Exchange.**—"Par of exchange" means equal of exchange. There is a "mint par of exchange," and also what might be termed a "commercial par of exchange."

The mint par of exchange between the United States and foreign countries is the actual value in our money of the pure metal contained in the coins

representing the units of money of the various countries. The Director of the United States Mint is required at stated periods in each year to proclaim the values of these coins or units in our money for the purpose of computing the worth of importations of goods and also the amount of customs duties assessable thereon. The value of gold coins, as fixed by the Director of the Mint, rarely ever changes, since the weight and fineness of the gold units of countries are fixed by law—in the United States by act of Congress, in Great Britain by act of Parliament.

The mint par of exchange of the English pound or sovereign in our money was in normal peace times $4.8665; of the French franc and the franc of the Latin Union countries, 19.3 cents; of the German mark, 23.8 cents; of the Scandinavian krone, 26.8 cents; and of the Holland gulden or guilder, 40.2 cents; and for many years it was the same. While these values as furnished are not exactly correct, they are sufficiently accurate to serve the purpose intended, and were accepted for all computations at the custom houses.

§ 306. **To find the Par of Exchange.**—In order to determine the actual mint par of exchange between any two countries, it is necessary only to divide the weight of the pure gold in the gold unit of one country by the weight of the pure gold in the coin of the other country. The mint par of exchange between the United States and countries having silver monetary units is arrived at in the same way, but as the price of silver fluctuates, the value of silver coins frequently changes.

As an illustration of how the pars of exchange

are arrived at, we will take for example the mint par of exchange between the United States and Great Britain. Our gold dollar (which is our unit of money of account) weighs gross 25.8 troy grains and is 9/10 fine, 1/10 alloy being allowed to increase its durability, which, if deducted, leaves 23.22 troy grains of pure gold. The sovereign contains gross 123.274478 troy grains and is 11/12 fine, which leaves the pure gold in the sovereign 113.001603 troy grains, which if divided by 23.22, the pure gold in the United States dollar, gives $4.866560, the mint par of exchange.

If you divide the normal value of the sovereign ($4.8665) by 20 (there being 20 shillings to the pound), it will give you the actual value of the shilling in our money, or if you divide it by 240, the number of pence to the pound, it will give you the value of the penny in our money (a fraction over 2 cents).

§ 307. **Commercial Par of Exchange.**—Now, as to the commercial par of exchange, if you add to the mint par of exchange between two countries the cost of transferring the coin or bullion, which involves freight charges, insurance, interest, commissions, and sometimes discounts, you will arrive at what would be termed, under normal conditions, the "commercial par of exchange," or the amount necessary to discharge a debt of a merchant in one country to a merchant in another country.

In further illustration of the commercial par of exchange, if the United States owed England exactly the same amount that England owed us, the debts between these two countries could be paid without

the intervention of money, and the commercial price of exchange would be at par. If, however, we owed England a greater amount than it owed us, exchange here would be higher, and in England lower, and vice versa. In other words, exchange in the United States would be at a premium, and in England at a discount, the premium in one case being about equal to the discount in the other.

§ 308. **Quotations of Rates.**—Quotations for foreign exchange, such as checks, drafts, commercial bills, etc., are rarely understood except by those familiar with the business. In quoting the rate of exchange for drafts, checks, etc., on countries other than France, Germany, and sometimes Italy, the rate quoted is per single unit, that is, so much in our money per pound sterling on England; krone on Norway, Sweden, and Denmark; ruble on Russia, etc.

Exchange on France and Germany, when quoted by dealers at smaller places, would be the same—so much per single franc or mark; but in the larger cities it is the custom, when quoting rates for francs, to quote the number of francs and centimes that will be allowed per $1, as, for example, 5.15 5/8—meaning that for each $1 you would be allowed 5 francs 15 5/8 centimes.

On Germany the quotation would be for 4 marks instead of 1; for example, 95 5/16—meaning that for each 4 marks you would have had to pay 95 5/16 cents.

The allowance of 5/8 of a centime per $1, considering that one whole centime is worth only 1-5 of a cent in our money, and a fraction like 5-16 of a cent

in our money on 4 marks, no doubt seems to most people like a very small item, but on a transaction of 100,000 francs (about $19,400 in our money) 5/8 of a centime per dollar would make a difference of over $28, and 5-16 of a cent per 4 marks on 100,000 marks (normally about $24,800) would be a difference of over $78, or over $15 on each 1-16 of a cent.

§ 309. **Peculiarity of French Quotations.**—One peculiarity in the French quotations is that the rate is always advanced or lowered by 5/8 of a centime; for illustration, the next lower rate to 5.15 would be 5.15 5/8, then 5.16¼, 6.16 7/8, 5.17½, etc., there being just 5/8 between each quotation. Bear in mind, the greater the number of francs and centimes allowed per dollar, the lower would be the rate, since, as the quotation is per $1, the more francs you would receive for your money. One reason assigned for this method of quoting the French franc, which is the reverse of that in other kinds of exchange, is 5/8 of a centime is equivalent to 1/8 of 1 per cent in the pound sterling, and as most of the French exchanges was formerly covered or paid through English exchange. this method served a convenience in figuring. The other reason is that as there were 5 francs to the dollar, 1/8 of 1 per cent on 1 franc would call for 5/8 of 1 per cent on 5 francs, the equivalent of $1.

But these quotations on francs by 5/8 of a centime, though they served every purpose a few years ago, are not now sufficiently close to meet the competition of the present day and are supplemented with fractional quotations, such as 5.15 5/8—1.32, or 5.15 5/8—1-16, or 5.15 5/8 plus 1-32, etc. These plus or minus fractions do not apply directly to the rate,

but mean 1-32, 1-16, 3-32, etc., of 1 per cent plus or minus the equivalent amount in American money, which is added or deducted as the case may be.

§ 310. **German and English Quotations.**—Quotations for German exchange, where quoted for 4 marks instead of a single mark, were also supplemented by the plus or minus fractional quotations; as, for example, if 95 5/16 per 4 marks was thought a little too high, it would be quoted 95 5/16 minus 1-32 of 1 per cent, which on a transaction of 100,000 marks would make a difference of about $7.50.

In large transactions the quotations on English exchange (which are generally confined to eighths of a cent per pound) are often supplemented with the quotation "plus 1.00," which means $1 additional will be charged on each 1,000 pounds, making a difference of 10 points in the rate. That is, a quotation of 4.87 1/4 plus 1.00 would be $4.8735, and it is not unusual in very large transactions to advance or lower the rate by five hundredths of a cent per pound, such as 4.87, 4.8705, 4.8710, 4.8715, etc., each five hundredths of a cent per pound making a difference of $5 on each 10,000 pounds, or $250 on a transaction of 500,000 pounds (nearly $2,500,000 in our money), often made by large financial institutions in a single day.

§ 311. **Meaning of Newspaper Quotations.**—As an illustration let us take a clipping from the Chicago Tribune, quoting the rates for "foreign exchange." Under the heading "Foreign Exchange Market" it starts by saying: "Foreign exchange closed steady at the following rates." "Steady"

means a demand and prices likely to remain as they are. "Firm" would mean good demand, with prices tending upward; "strong," a large demand, with prices certain to go higher. "Dull" or "weak" would, of course, mean very little or no demand, with prices tending lower.

Under the heading of "selling" rates we would find:

Cable transfers, London	5.88
Checks, London	4.87 1/2
Checks, Paris	5.16 1/4 plus 1-32
Checks, Berlin	0.95 7-16
Checks, Holland	0.40 1/4

"Selling rates," in this case, mean the prices that were charged customers who wished to remit abroad.

The first item, "cable transfers," is where amount of money desired to be paid abroad is deposited here, and the bank or concern with which you are transacting the business cables its correspondent abroad to pay the amount to the person at the address you designate. Of course, it would be necessary for those making such transfers to have funds or credits abroad for such purpose. When it is desired to have money paid at interior places, the cablegram will be sent to the nearest city at which the bank or concern here has funds, and it will be forwarded by mail there, causing a delay of perhaps only a few hours. Ordinarily, within one or two hours from the time you deposit the money here it will be paid to the person abroad whom you designate.

The quotations for checks London, checks Paris, and checks Berlin are the rates at which they would

have sold you a demand check or draft payable at those particular cities. If you wanted a check payable at some other point in Great Britain, France, or Germany, they undoubtedly would have charged you a higher rate, since their balances are kept only at principal trade centers, and their arrangements for payment of their paper at interior or other points are that the bank correspondents there will honor their paper and reimburse themselves by drawing upon the trade centers for the amount plus their commission for cashing, hence adding to the cost of performing the service.

The next item is "checks Holland 40 1/4." This means they would charge for a check or draft on any point in Holland at the rate of 40 1/4 cents per gulden or guilder, the money of that country.

Following the above there would appear in our newspaper clipping the heading "Buying Rates," which mean the rates at which the banks purchased the various classes of commercial paper named. The quotations were as follows:

60 days London bankers	4.84 1/4
60 days London documentary	4.84 1/2
3 days Antwerp	5.18 1/8 less 1-32
3 days Hamburg	0.95 1/4 plus 1-32
60 days Holland	0.39 15/16

The first quotation, "60 days London Bankers 4.84 1/4." was for drafts drawn by bankers payable sixty days after sight (meaning after acceptance abroad) against their account in a bank upon which draft is drawn. The banker issuing such draft has 60 days (if necessary) in which to place funds abroad

to meet payment of this draft; therefore a bank will often sell its sixty-day draft with the belief that it will be able to purchase and place the amount abroad to meet the same before draft is due, at a lower rate than at which it sold, and thus make a profit. There are other cases where a bank will sell its sixty-day draft on the market to obtain the use of the money for that period.

The next item, "60 days London documentary 4.84 1/2" is what is known as a foreign commercial bill of exchange, which is explained more fully later. The documents referred to are the bills of lading and the insurance certificates, representing a shipment of goods abroad. The draft is drawn payable sixty days after sight, which is the time credit extended to purchaser by the seller.

The three-day quotation mentioned on Antwerp and Hamburg are for drafts payable three days after sight. The custom of drawing drafts three days after sight on points in European countries outside of Great Britain is because no days of grace are allowed on the continent as in Great Britain, and the three days are granted to insure payment being made, and thus avoid "protest fees," which often are very exorbitant.

The sixty-day Holland bills are issued and paid under practically the same conditions as the "sixty-day London bankers" just mentioned, although drawn against commodities exported. They are what is termed "clean bills" by reason of there being no documents attached.

We might also find in our paper the following items which pertain to foreign exchange transactions:

Under the head of "Money Markets of the World" it reads: "Discounts at London, 2 3/4 per cent; Paris, 2 7-16 per cent; Berlin, 1 5/8 per cent." Foreign discount rates mean the rate per cent charged or allowed on drafts discounted or paid before due. These particular rates mentioned apply to drafts drawn on bankers.

Here is also another former newspaper quotation "Sterling exchange—posted rates 4.88, actual rates 487. 1/4, documentary rates 4.84." Posted, or nominal, rates are those posted daily on bulletins of leading New York dealers in exchange for use of the general public, and apply more particularly to smaller sums. Actual rates are inside terms made to brokers or large buyers for large sums. Documentary rates are for commercial bills of exchange.

§ 312. **Before and After Clearings.**—Here is still another newspaper quotation, which while not applying directly to foreign exchange, materially affects its rates in the western market: "New York exchange —30 cents discount before clearings, 40 cents discount after clearings." The expressions "before" and "after clearings" mean before or after the meeting of the bank clearing-house, a meeting held each day about 11 a. m. by representatives of the different banks to exchange debits and credits with each other. "New York exchange" means checks payable by a bank in New York. Thirty cents discount in this case would mean that New York exchange, in sales between banks (not as a rule with the public), would be sold at a discount of 30 cents for each $1,000. If New York exchange were quoted at a premium of 30 cents, they would charge 30 cents additional

per $1,000. The reason why the rates for New York exchanges affect the rates for foreign exchange in the West is that the rates in the West and elsewhere in the United States are based on—or controlled by—the rates in New York, because New York is the principal buying market. Therefore if New York exchange here is at a discount, on large transactions banks would sell you a draft on London or other foreign city at the rate of 30 cents per $1,000, less than you could buy it for in New York; or, if at a premium, the rates would be that much per $1,000 higher than New York providing of course you paid in cash or local funds.

Questions for Review, Chapter XIII.

1. What developments of modern business caused the establishment of foreign departments in large commercial houses?

2. Is there any special demand for young men with a knowledge of foreign exchange and foreign shipping?

3. What is a good definition of foreign exchange?

4. Why is the system of exchanging debts through the medium of commercial paper adopted?

5. What items are charged up to the United States as an offset amount, if balance of foreign trade is in its favor?

6. Why is a knowledge of the monetary system of foreign countries desirable for a young business man?

7. Is paper money ever accepted for its full face value outside of the country from which it emanates?

8. Is it ever legal tender in foreign countries?

9. What is the only international money, and why?

10. What is meant by the "fineness" of gold or silver coins?

11. What determines the value or price of the gold money of account in commercial countries?

12. Is the price of gold affected by either an absence or a scarcity of the supply?

13. How are gold shipments between the United States and Europe handled?

14. What is the "fineness" of commercial bars of gold?

15. What is meant by "money of account"?

16. What five countries are now comprised in the Latin Union?

17. What is the normal value of the English sovereign in American money?

18. What is meant by sterling exchange?

19. What is the meaning of the term "rate of exchange"?

20. What is the difference between "direct" and "arbitrated" exchange?

21. What causes contribute to the fluctuations in the price of exchange?

22. How can the par of exchange between any two countries be determined?

23. What is the commercial par of exchange?

24. Give a simple illustration of the commercial par of exchange.

CHAPTER XIV.

Foreign Exchange

(Continued)

Section 313. Commercial Bills of Exchange.—The basis of a foreign bill of exchange is, as its name implies, a commercial transaction of international character, which consists in the purchase of goods or commodities in one country for export to another country.

The draft represents the money value of the goods which is due the exporter.

The bill of lading is the contract between the transportation company and the shipper for carrying of the goods, and also serves as the order for their delivery.

The insurance certificate is the certification of the marine insurance company of reimbursement in case goods are lost by fire or accident while en route on the ocean.

These three documents—the draft, bill of lading, and insurance certificate—constitute what is termed a "foreign commercial bill of exchange." They are almost invariably issued in duplicate for fear one set may be lost in its transmission abroad by mail, one

of each set being marked "original," the other "duplicate;" or sometimes one of the drafts will read "first of exchange," the other "second of exchange."

Foreign commercial bills of exchange are also known as "documentary bills of exchange," by reason of the bill of lading and insurance certificate accompanying the draft. It is customary to send the original of the three documents by first steamers, the duplicates or seconds by following steamer. If the original set is lost, duplicate will serve same purpose.

§ 314. **Commerce and Exchange.**—Trade between countries may be said to be conducted in a manner somewhat similar to that employed here between cities or towns, except that the method of payment or reimbursement to the shipper necessarily differs by reason of greater distance, the difference in kind of money used, and commercial customs in the two countries. To obtain payment for goods shipped to a foreign country which perhaps would not arrive at their destination for several weeks and possibly months, according to distance, and whether by fast or slow steamer, to say nothing of the fact that to some countries steamers only leave our ports semi-monthly or monthly, it is the usual custom of the shipper, whom we term the exporter, to sell his commercial bill of exchange against the shipment in advance to the highest bidder; and he rarely experiences any difficulty in finding a ready purchaser.

Our exporters, in competing with foreign manufacturers, must take into consideration cost of transportation, insurance on goods, customs duties, difference in value of money, and the probable price

at which they can discount or sell their commercial bills against the same. Time credit must also be extended to the buyer. If our exporters had to wait for payment until the maturity of their bills, it would mean the tying up of a large amount of capital and possibly prevent their competing successfully.

§ 315. **A Typical Transaction.**—The process by which a foreign commercial bill of exchange drawn against commodities exported is created and handled, and reaches its termination, may best be illustrated by an actual transaction, and we give below exact terms of a commercial bill of exchange drawn against a shipment of flour made by a leading exporter—flour being one of our chief exportable commodities.

The shipment of flour in question, destined to Liverpool, England, was delivered to the Soo freight line at Minneapolis, operating over the Minneapolis, St. Paul & Sault Ste. Marie and Canadian Pacific Railroads, and a through bill of lading in duplicate was obtained. This through bill of lading is a form of contract, issued by special arrangements with connecting ocean steamship lines, by the terms of which it is agreed, under conditions printed thereon, to transport the shipment through to the destination at the foreign port (Liverpool). It states the number of packages, how they are marked, their contents, the particular grade or brand of flour, and the name and location of the party for whom the goods are intended. It is negotiable only by indorsement of the exporter.

Upon presentation of this evidence of shipment, a marine insurance company has issued a certificate

of insurance, under the terms of which it agrees to reimburse the owner of the goods in case of the loss of the shipment by fire or accident while en route on the ocean. This shipment, as is the usual custom, is insured for about 10 per cent in excess of its billed value.

The exporter then attaches to these documents a draft for the amount for which the flour was sold, namely, £457 12s 10d. Had his shipment been destined to a point in Germany, the draft would have been drawn in marks; if to France, in francs, and so on; usually in the money of the country where it is going; but quite often it will be drawn in English money, although going to some other country, by reason of English exchange being preferred.

In this case the exporter agreed to allow the buyer sixty day's time in which to pay the draft, after its presentation. The draft reads "60 days after sight of this first of exchange (second unpaid), pay to the order of ourselves 457 pounds 12 shillings and 10 pence, against Soo line, through B. L. No. B. 1548, dated.............., 19........, for 2,000 sacks of flour branded Dakota," and is signed "Northwest Consolidated Milling Co., H. E. Kent, cashier," who are termed the drawers. In the left corner it reads: "To James Corwith & Co., Liverpool, Eng." They are the buyers, or as we term them, the drawees.

Now, these three documents, drawn to the order of the exporters (Northwestern Consolidated Milling Co.), comprise a commercial bill of exchange.

Upon the same day that these documents were issued, and practically before the flour had started

on its long journey, the exporters offered this bill of exchange for sale. It was sold to the Security Bank of Minneapolis (that being highest bidder) at the rate of $4.84 per pound, who in turn resold it to the American Express Co. at $4.84 1/8 per pound. The indorsement on the back of the draft showed the papers to have been sent to Liverpool for collection. The bank at Liverpool notified Corwith & Co. to call and "accept" the draft, which they did, by writing the word "accepted" and the date over their signature.

About fifteen days afterward the flour arrived by slow steamer, and, being in immediate need of it, Corwith & Co., in order to obtain the bill of lading, had to pay the draft; the instructions stamped on same being; "Surrender documents upon payment only."

Now, as Corwith & Co. paid this draft forty-five days before it was due, the bank, as is customary allowed them the prevailing rate of discount applicable to that class of bills, which was 2 per cent (or £1 3s. 5d.) The difference, £456 7s. 5d., less cost of revenue stamps, was placed to the credit of the American Express Co. by the bank which closed the transaction.

Had the instructions on draft read "Surrender documents upon acceptance of draft," the bill of lading would have been delivered when draft was accepted, thus enabling Corwith & Co. to obtain goods at once and pay draft sixty days afterward if they desired.

The method used in determining what this commer-

cial bill was worth when buying it here was based upon the following:

(a) What demand exchange upon Liverpool could be sold for.

(b) The cost of revenue stamps to be affixed when draft was accepted abroad.

(c) The interest for the number of days for which draft was drawn, plus three day's grace, at the rate per cent bill could be discounted.

For illustration:

\$4.8775	Demand rate on Liverpool.
0.00244	Cost of revenue stamp (1-20 of 1 per cent, of rate or 1 shilling per 100 pounds).
\$4.87506	
0.01676	Interest 63 days 2 per cent (disc. rate).
\$4.85830	Parity or cost per pound at maturity or if discounted.
4.84125	Rate per pound at which purchased.
\$0.01705	Profit per pound.
	Or \$7.78 on £457 12s. 10d.

§ 316. **Foundation of Foreign Exchange.**—The buying of foreign commercial bills of exchange is the principal medium of bankers and foreign-exchange dealers in placing funds to their credit in banks abroad against which they issue checks, drafts, letters of credit, etc. It is the foundation of most of our foreign-exchange transactions. It is the principal source of profit in the business. It enables manufacturers to sell their goods abroad for cash in advance.

Foreign bills of exchange vary as to conditions of payments abroad. If conditions of sale between buyer and seller of the goods were that goods were to

be paid for upon delivery, the instructions accompanying bill would say "documents for payment" (expressed d. p.), meaning not to deliver the bill of lading (which would enable drawee to get goods) until draft had been paid.

If instructions said "documents for acceptance" (expressed d. a.), it would mean that bill of lading could be delivered when draft was accepted, thus enabling drawee to obtain goods at once and pay draft any time within sixty-three days (if a sixty-day bill).

§ 317. **Buying Commercial Bills.**—The buying of commercial bills of exchange can be safely undertaken only by those thoroughly familiar with that business. It is practically equivalent to loaning money upon security you have not seen. If the drawee of the bill has unquestionable responsibility, that of course eliminates the principal risk of loss; but if great care is not exercised in examining bills purchased, a slight imperfection or error might cause a long delay in adjusting the error, thereby causing loss of interest. If through a misunderstanding or for other cause goods are not accepted, they have to be sold to the best advantage for the account of the owner of the bill, and the proceeds of the sale are applied toward payment of the draft. If there is a deficiency, it is collected of the drawer of the bill—the exporter.

The buyer of commercial bills should know the market value of the goods exported and the financial standing of the drawer or exporter; should see that the bill of lading is correctly dated, corresponds with the shipment made, is duly signed by the agent or

proper official of the railway or freight line; that it corresponds with the insurance certificate in the various particulars; that if more than two copies were issued, he has them all; that there are no printed or stamped conditions thereon that would be likely to render it valueless under possible emergencies. If goods are perishable, see that they are routed by fast freight and fast steamers. If bill of lading only covers shipment to the seaport, as is sometimes the case when shipped from small inland places where through bills of lading are unobtainable, arrangements must be made through your own agent to have same exchanged for ocean bill of lading at seaport. Any error or incompleteness of the documents will cause a delay in payment or expenses for cablegrams to adjust them.

§ 318. **Hypothecation Certificates.**—It is the custom of buyers of foreign commercial bills of exchange to exact of exporters what is termed a "hypothecation certificate." This certificate, after describing the nature of the shipment and the documents in question, states in effect that the bill of lading is lodged as collateral security for the acceptance and payment of the draft; that in case the drawee declines to accept the draft, or it is not paid at maturity, the owner of the bill is authorized to place the property described in the hands of brokers for sale for account of whom it may concern, and apply the proceeds toward payment of the draft and expenses incurred; and that in case of a deficiency the seller agrees to pay amount on demand. Sometimes exporters give a general hypothecation

certificate to apply to any and all bills of exchange purchased of them.

§ 319. Certificates of Insurance, Etc.—Certificates of insurance on shipments exported are usually for a sum of from 10 to 20 per cent in excess of the stated value of the goods. They should be carefully examined to see that there is no clause which would render insurance void in event of the shipment not going forward at a specified period, or that it would expire before arriving time of the goods in case of delay or by reason of any of the possible emergencies likely to arise.

The buyer of foreign commercial bills of exchange must be familiar with the revenue laws and commercial customs of all the foreign countries, as well as the various rates of discount upon the several classes of paper as they change from day to day.

§ 320. Various Rates of Discount.—You should always bear in mind that a different rate for discount applies to the different classes of bills. For instance, on documentary bills where documents are for payment, the discount or rebate rate is 1 per cent below the bank of England official minimum discount rate. If drawn on firms (not bankers) and documents are for acceptance, the discount rate would be 1/4 or 1 per cent above the private discount rate for bankers' bills.

If drawn on bankers, whether documentary or otherwise (which are always for acceptance), the discount rate would be the private rate of discount, which fluctuates according to demand and supply of such bills; and in case of large transactions it is

customary for buyers of such bills here to cable their correspondents abroad for a discount rate to apply on bills to arrive by next mail or for a stipulated period before buying, in order that they may know exactly at what rate the bills can be discounted upon their arrival. Without such previous arrangement the discount rate might change materially and result in loss upon the transaction.

§ 321. **The Bank of England Rate.**—The Bank of England official minimum discount rate is fixed by the directors of the Bank of England at their meetings upon Thursday of each week, and their decision usually appears in the financial columns of our daily papers reading thus: "Bank of England minimum discount rate unchanged," or "the Bank of England increased (or reduced) its minimum discount rate to 3 per cent," etc.

The private discount rate is the rate at which private banks (meaning all those in Great Britain other than the Bank of England) will discount bills of exchange for account of the owners or last indorsers, and this discount is governed by the Bank of England discount rate, and also by the supply of bills in the market for discount, but, except under unusual conditions, the private discount rate will always be about 1/4 of 1 per cent below the Bank of England official minimum discount rate.

What are known as "rebate rates" apply only to time commercial bills of exchange drawn on firms where documents are for payment; that is, where bill of lading is delivered only upon payment of the draft. This rebate is an allowance made to the payee or drawee from the face amount of the draft, if paid

before maturity, or before due, and such rebate is 1 per cent below the Bank of England official minimum discount rate.

Theoretically the Bank of England controls the discount market in London. This control is sought to be maintained through the official rate of discount at the bank, which is advanced when its stock of gold bullion is being largely drawn upon for export to the United States or European countries. If the conditions prevail to make it inadvisable to raise the bank rate, a higher price for gold will be charged; or if it finds difficulty in controlling the discount rate, it will create a demand for discounts by borrowing on its security, thereby increasing the demand for discounts.

Unlike the Bank of England, which undertakes to control the stock of gold by advancing the discount rates, the Bank of France protects its stock of gold by increasing the price of gold when withdrawal of a large amount is threatened. The official discount rate, rarely changes except in case of financial or political crises.

§ 322. **Safe and Unsafe Bills.**—There are certain classes of commercial bills which, unless special care is taken, are regarded as unsafe. In the case of cotton, on account of the different grades and the fact that there is so great a difference in the price of the different grades, and its being so easy to substitute one grade for another, the bills against shipments should be purchased only of well-known and responsible shippers or indorsers.

Grain shipments are all right, providing the grain

inspector at the shipping point is of good reputation; otherwise he might inspect as No. 2 what was billed as No. 1.

Perishable goods are always more or less risky, on account of the danger of delay and of the goods spoiling. You should see that perishable goods are sent by fast freight lines and fast steamers.

Pianos, organs, musical instruments, and such goods have imaginary value, and could rarely be sold at the price at which billed.

"Banker's reimburse bills" are those where drafts are drawn against a shipment exported, upon a banker, the documents being for acceptance. When buying such bills you should keep a record showing names of indorsers and keep close watch of the drawer or shipper until the bill is paid. The shipper should be responsible, and, if buying a considerable amount of such bills on the same drawee, you should ascertain through your correspondent abroad the responsibility of the drawee, and be sure you do not buy more bills against a single drawee than his ordinary business requirements would indicate he needed.

Banks selling commercial bills of exchange (documentary) sometimes stamp them, for example, "In case of need with the Bank of Scotland, London," or some other bank. This is done to avoid charge of intermediate banks for indorsing or protesting drafts, which charge is usually very exorbitant. When so stamped, it is a notice to all holders of the draft they may call upon the bank named, if the draft is not promptly accepted or honored, for relief; therefore there is no necessity for protesting. The bank mentioned will, by previous arrangement, always honor

such drafts and charge to the account of the bank indorsing such notation thereon.

§ 323. **Clean Bills of Exchange.**—"Clean bills" of exchange are those having no bill of lading attached, although they may have attached insurance certificate and an invoice of shipment. If these clean bills are drawn upon firms, they are subject to a discount rate of 1/4 of 1 per cent above the private discount rate of the day; but if drawn upon bankers, they will be discounted at the private discount rate.

Commercial bills of exchange drawn by exporters without documents are generally upon their own house or branch abroad, and are against funds which have accumulated to their credit from payments for shipments previously made. Exporters before selling their own bills of this kind usually wait until the rates for exchange here are high. Such bills are discountable.

Commercial bills of exchange drawn upon bankers are always for acceptance, unless otherwise specified, and the discount rate applying to such bills is the private discount rate of the day.

§ 324. **Documentary Bills.**—Documentary commercial bills of exchange drawn upon firms or banks where documents are for payment cannot be discounted upon the market, as in the case of such bills where documents are for acceptance, for the reason that banks abroad to which bills are sent for collection will not undertake to discount commercial bills unless they are what is called "clean" bills—that is, those having no documents or those which permit the

documents to be delivered when the draft is accepted by the drawee.

A documentary or commercial bill of exchange, accompanied by instructions from the exporter or drawer, to deliver documents (bill of lading, etc.) only upon payment of the draft by the importer or drawee, which are drawn upon a firm, are subject to a discount rate of 1 per cent below the Bank of England official minimum discount rate. If the instructions are to deliver documents upon acceptance of the draft, the same rate of discount by the holder (bank) at 1/4 of 1 per cent above the private discount rate of the day.

§ 325. Revenue Stamps on Drafts.—Drafts drawn in the United States payable in foreign countries are subject to the revenue laws of such foreign countries, and the cost of stamps so affixed abroad must be paid by the holder of the bills, who in turn generally charge to the bank or banker from whom they receive the same for collection. The amount of revenue stamps varies according to the country, and in most European countries has been largely increased since the great war.

§ 326. Miscellaneous Charges.—European banks are noted for charging for every item possible in connection with every transaction handled—such items as postage on letters sent to you during a certain period, cost of cablegrams, check-books, envelopes, stationery, and often a lump sum for items that may have been overlooked. For collecting commercial bills of exchange they will usually charge, in England, about 1-20 of 1 per cent, or 1 shilling per cent; France, 1-16 per cent; in Germany, 1-20 per

cent in the larger places and from 1-16 to 1/8 per cent in the smaller places.

Interest at thirty, sixty, or ninety days, with three day's grace added (as allowed throughout Great Britain), can easily be arrived at by using printed tables furnished by some of the leading foreign exchange bankers, which give the proper decimal of a pound to deduct for interest and revenue stamps at the various rates. These printed tables also give the same information for figuring German and French bills of exchange.

§ 327. **Complicated Transactions.**—Exchange transactions become more complicated when one country or place, as is often the case, discharges its debts through another country by means of bills of exchange drawn upon a third country or place; as for instance, a merchant in Chicago importing goods from China would pay the exporter in China with a check upon London, for the reason that such check would be more desirable to the shipper in China, since the demand for exchange in China is greater upon London than upon the United States.

When in any market the demand for exchange on a certain country or place is greater than the supply, the deficiency is usually supplemented by bills on other countries having a more favorable exchange with the latter.

In the East Indies those who ship to America usually draw upon London instead of America. In New Orleans, exporters of cotton, etc., to Russia, draw upon London instead of St. Petersburg. This is because England does more business with those

countries than America; besides, London is regarded as the greatest money center, and exchange upon that city is usually more favorable and can be used to better advantage.

§ 328. **German Requirements.**—Importers in Germany will not accept drafts drawn against importations until the duplicate documents (duplicate draft, bill of lading, etc.,) are presented, and, in order to have the original draft accepted immediately upon its arrival, banks in this country when forwarding such bills for acceptance and collection will attach to the original draft a memorandum agreement to the effect that the duplicate bill of lading is in their possession, and their correspondents (banks) are requested to guarantee the acceptors (importers) that the duplicate documents will be delivered to them as soon as received, which guarantee also gives the number and amount of draft, the name of drawer, and the signature of a proper official of the bank or financial institution forwarding the same.

§ 329. **Convenience of Sterling Exchange.**—The volume of transactions in French, German, and other continental exchange is quite small compared with that of sterling exchange. The reason for this is that most banks have accounts or balances only at London, and where balances are kept in other European cities they are usually small as compared with their London account. Therefore, in making remittances to Paris, Berlin, or other cities on the continent, it is most generally effected by transferring the funds to those cities from London, which can generally be handled very satisfactorily, by reason of most large European banks having branches in

London. It is customary, however, for banks, before transferring funds from their London accounts, to carefully figure out the difference in cost between a remittance direct from here to the city where it is desired to place the funds and the expense of transferring it from London. This can easily be determinded by ascertaining the rate of exchange between London and the point referred to.

§ 330. Precautions Against Wrong Payment.— A "crossed sterling check" is one payable either to bearer or order, having the name of a banker, or two parallel lines and the abbreviation "& Co.," written or printed across the face, thus: "................ & Co." The effect is to direct the bank upon which it is drawn to pay the check only when coming to it through some other bank. It is intended as an additional safeguard against wrong payment.

In most foreign countries it is the custom of bankers and others in the cashing of checks, whether drawn payable to order or bearer, to pay to the person presenting the same, and under the laws existing in these countries the paying bank or banker would not be held liable for wrong payment. As a reason for this seemingly risky method, it is claimed that on account of the very severe penalty imposed for forgery under their laws, the requiring of strict personal identification, as exacted by banks in the United States, is found unnecessary.

As an additional precaution against wrong payment, the laws of Great Britain require that where a check is crossed, as explained above, while not requiring personal identification, it must be cashed

through some bank other than the one upon which it is drawn.

Notwithstanding the requirements under the laws, a reasonable amount of care is exercised by banks to prevent losses by incorrect payment, and in some countries a stranger presenting a check drawn to his order is required to make affidavit that he is the person named, for which affidavit the paying bank exacts a small fee.

Questions for Review, Chapter XIV.

1. What is the basis of a foreign bill of exchange?

2. What three documents are comprised in a foreign commercial bill of exchange?

3. What is the nature of the bill of lading?

4. How are documentary bills of exchange usually sent abroad?

5. Does the duplicate set of the three documents serve the same purpose if the original set is lost?

6. What is the usual custom of exporters with regard to the disposal of commercial bills of exchange?

7. What is meant by stamping the draft "Surrender documents upon payment only"?

8. What is the foundation of most of our foreign exchange transactions and the principal source of profit in the business?

9. What is the advantage to manufacturers of the foreign exchange system?

10. What information should be obtained before commercial bills are bought?

11. What are hypothecation certificates?

12. Does the same rate of discount apply to the different classes of commercial bills?

13. Who fixes the Bank of England discount rate and how often is it fixed?

14. What is the "private discount rate" in England?

15. What is meant by "clean bills" of exchange?

16. What miscellaneous charges are made by European banks in connection with foreign exchange transactions?

17. Why is sterling exchange most convenient in the transaction of European business?

CHAPTER XV.

Capital and Its Control

Note.—This chapter is devoted to a discussion of capitalism and state control of capital, by Professor William Morse Cole, of the Graduate School of Business Administration, Harvard University. It has been indorsed as "an excellent refutation of the fallacies of Communism" by the officials of many large financial organizations, including the American Short Line Railroad Association and the Metropolitan Life Insurance Company. In these days of Bolshevism, Sovietism, and other forms of Communistic agitation it is well for the business student to have a clear understanding of the nature and functions of capital and its true relation to the well-being of the community.—Ed.

Section 331. Are You a Capitalist?—Suppose you are a savings-bank depositor, or a holder of an insurance policy. That means that you have saved money. Did saving involve a sacrifice? Did you, in order to save, give up what you very much desired and even thought you had a right to buy? Did you ever give up something that you had hoped to buy for those who are dear to you in order that you might save the insurance money, or make a savings-bank deposit? Did the payment on a Liberty Loan bond or an insurance premium, or on a savings-bank account, ever come hard? If so, you know what saving means. If you have lent money to the Government, if you have placed money in a savings bank, if you have paid premiums on a life insurance policy, you are a capitalist—not a make-believe or imaginary capitalist, but an actual capitalist, whose capital is furnishing a part of what is called "capitalism."

§ 332. **What Is a Capitalist?**—You know that more food can be produced, more clothes made, more houses built, with tools and machinery and the means of conveyance like wagons, trucks, and railroads, than without these assistances for labor. These things are capital, and if you are a capitalist you own some of them. Capital is nothing but the product of the past saved and devoted to the assistance and production of the present and future. You know very well that if you have saved a hundred dollars out of your earnings and have loaned or invested that saving, you have never had the satisfaction of spending that money. It was yours to use; you did not spend it.

If the earnings that you have saved are to do you any good, you must put them to use; and you have a right to decide whether you shall now spend them and get the satisfaction you previously earned, or shall lend to someone else that power of getting satisfaction. If you choose to spend them, you may now enjoy the fruits of your past labor; and any interference with that right is robbing you of your wages, for wages that may not be spent are not real wages. If, on the other hand, you choose not to spend them but to lend to someone else, any interference with your right to demand the return of them by the borrower is equally robbing you of your wages.

It is true that capital is the product of labor—for no capital could exist unless someone consumed less than he produced. The fact that the capital exists shows that the labor which produced it has not consumed what it earned. To possess such unconsumed earnings is to be a capitalist. If one possesses them

honestly, one is an honest capitalist; if one possesses them dishonestly, one is a dishonest capitalist.

§ 333. **Getting Along Without Capital.**—If all the capital in the world were destroyed, men would work only with their bare hands upon the bare soil. What they would produce would not be enough to feed, clothe or shelter anything like a tenth of the world's population today on the average scale to which the world is accustomed, unless we were contented to live with few of the comforts and conveniences of food, shelter, and clothing that we now have—to say nothing of other comforts. Have you ever tried to do any important work without tools or other mechanical assistance? If so, you know a little of what it means to work without capital. Suppose, moreover, that you had no raw material, lumber, iron or cloth, to work with. How much could you have done?

§ 334. **Loans to the Government as Capital.**—What has become of what you have saved? If you have lent your money to the United States government for war loans, it has gone into ships, into food and clothing for soldiers, into ammunition, and into many other things, part of which has been saved and assists in producing more wealth after the war, and part of which has gone into the attempt to stop the ravages of those people who believe that only "might makes right." It was because we had capital in abundance in this country, capital which might be devoted to the production of war necessities that is was possible for us to oppose the Prussians who were attempting to establish their tyranny over

the world and force everyone to live as the rulers of Prussia ordered.

§ 335. **Insurance Premiums as Capital.**—If your money has gone into life insurance, a large part of it (all that has not yet been needed for the payment of death claims, maturing endowments, and other payments to policy holders and the necessary expenses), has gone into a reserve fund, which is growing, ready for the various payments to policy holders. That fund has been invested by insurance companies as an important part of the capital of railroads, public service plants, government enterprises like the building of roads, public buildings, farm loans, dwelling house loans, and so forth. The people who borrow the money pay interest to the insurance companies, and this interest makes the reserve larger. So the insurance premiums that you have to pay are very much smaller than would be necessary if your money were not earning interest. A part of the capital of railroads, manufacturing establishments, and municipalities, that are making it possible for us to have as many comforts and conveniences as we now get, is your capital; and you are being paid for the use of it because with the aid of labor it produces more wealth. In fact, a large part of the railroads, the telephones, the telegraphs, and the other public enterprises that add to the comforts and interests of life are actually owned by these insurance companies. Therefore they are owned by you and others who have furnished insurance money.

§ 336. **Saving-bank Deposits as Capital.**—A large part of the money deposited in savings banks is lent

by the banks to the railroads, manufacturing establishments, and municipalities, and it is the amount earned by the banks through these enterprises that enable your bank deposits to grow. Your capital enables the enterprises to do more work and to produce more goods; and that is why they pay interest.

§ 337. Who Owns the Capital of the Country?— The capital of the country is not owned chiefly by a few rich men: it is owned chiefly by the common people. It is owned largely by those who hold savings-bank deposits and insurance policies, and by those who own a few shares of stock which they have purchased by means of saving, often hard and almost cruel, that you and others like you have made. Of all railroad stocks in the United States, about 92 per cent are owned by holders of few shares only. The stock of one large railroad is held by more than one hundred thousand owners, and almost half of these are women. Of the stock of another, with twenty-seven thousand holders, and nearly one-half women, more than twelve thousand holders are owners of fewer than eleven shares each. The savings-banks of Massachusetts alone hold over one billion dollars of investments of capital in business and government enterprises. The insurance companies of the United States have invested four billion three hundred fifty millions in enterprises, and this is the property chiefly not of the rich but of the thrifty common people. The colleges of the country have about $550 invested for each student enrolled, and from the earnings of these investments of capital the colleges are in part supported.

§ 338. **Who Controls Capital Today?**—Sometimes it is said that though the capital of the country is owned by the people, the bulk of it is controlled by a comparatively few men. That is true. Why? Because skill in management is a rare faculty and is at the same time a necessity for producing wealth today. Neither the average capitalist nor the average laborer is able to manage wisely what he contributes to the production of wealth. Management of a business requires knowledge and judgment of markets, both for buying and for selling, knowledge and judgment of qualities of goods, judgment of economical processes of manufacture and distribution. Knowledge and judgment of human nature, experience and judgment in getting along smoothly with people, knowledge of world conditions, and a great number of other things, such as a knack of foreseeing what is going to happen in the business world. The skilful manager contributes more by his thoughtful management to the production of wealth than much direct labor and much capital, and that is why he is so highly paid. He is usually cheap at the price. Every large business house is looking for more men with good managerial knowledge and judgment, and will pay big salaries to them. Such men often become important capitalists because they earn much in salaries, save much, and earn much with their savings; but they become capitalists in the same way, and with the identical right, that wage-earners on small pay become capitalists— by saving rather than spending their earnings.

§ 339. **The Saving and the Unsaving.**—Have your neighbors and acquaintances saved as you have? Doubtless some have not saved, because their incomes were small and their families large, and they had no margin out of which savings could be wisely made. Others, on the other hand, have failed to save simply because they see the present only and have no thought for the future. Some of them think that the world owes them a living, and therefore it is unnecessary that they should save. They are glad to make use of the capital of the world, but do not wish to contribute to it. Some of them doubtless think that you have been foolish to save; for they think that savings should be made not by individuals but by the state. Some wish to substitute states savings and state capital for individual savings and individual capital, and they wish to seize all capital now in existence and make a common state capital fund. Of the justice of this as between those who have been thrifty and have saved and those who have been thriftless and have spent, nothing need be said.

§ 340. **Two Systems.**—Since, however, the growth of capital is necessary if the world is to continue producing wealth as it now produces it, and since the total wealth to be distributed cannot be increased, unless the total capital for producing it is increased, a comparison of the two methods for the future provision of capital—individual control or state control—is important for everyone to make.

§ 341. **The End of Private Saving.**—If the state is to control capital and allow no one to get an income from the protection or use of it, no one will have

much motive to save; for all one can do with saving is to leave it in the hands of the State, and the one who saves will be no better off than the one who does not. Private voluntary saving will largely stop—and many opponents of what they call capitalism wish to prevent people from leaving what they call wealth to their children—in which case the last motive to save will be gone, so the State will have to provide the saving—for capital, as we have seen, in the form of materials of manufacture, machinery, and transportation facilities, etc., must grow with growing population.

§ 342. **The Beginning of State Saving.**—Yet even the state can provide for saving in only two ways; taxation, and giving in wages less than the total produced; that is, it will either take away people's earnings as taxes, or it will hold back at the source a part of the product. If, moreover, as is often recommended, the amount of taxes, or withholdings of earnings, is so large from those who produce most that it brings them nearly to an equality with those who produce least, people will have no inducement to take highly paid positions. They will not by study or training or care qualify themselves for high-paid positions. They will look for comfortable work, easily learned, at merely comfortable pay; for they will be no better off in better jobs. Then, doctors, engineers, inventors, managers, etc., will be scarce. What happened in Russia will happen here. The people there died for lack of medical care, and production has fallen off because the people able to direct industry are no longer directing it. No government of whatever kind can allow things to run

along in this way, for welfare depends upon production.

§ 343. **The Method of State Saving.**—Although it is good theory to say that under state control of capital everybody would choose such work as he wishes and is competent for, in practice the thing is not feasible. Suppose forty people wish to be doctors in a certain town, but only twenty are needed. The forty people must be supported, but the state cannot afford to support twenty in idleness—also most people would choose work for which they were not needed, and the few workers would not be enough to support the non-workers. The state, if it furnishes the capital, must control the use of that capital and choose the users of it. This is what most people fail to realize—that when the state controls capital and industry, it must control the workers, for there is then only one employer and the state must support all the people. This we don't see at first, when only a few industries are controlled by the state—like the post office; but when all are so controlled, there is bound to be conscription of labor—of women as well as of men.

The man who has remarkable skill as a craftsman, but who at the same time is fond of the country and wishes to work as a farmer, may nevertheless be put to work in the city where his talents may be used to the utmost, in spite of the fact that his desire is to remain in the country. The man who loves the city but has no particular skill at any work required in the city, especially since there will be a great supply of that kind of labor, may be ordered to live in

the country and do rough farm work, even though he would rather at a very much smaller income live in the city and have the comforts of that life. Since all capital will belong to the state, there will be no capital by which a man may start an enterprise of his own except with the permission of the state; he may not even start a little store in which he may delight to spend his time and earn a modest living. The very essence of state control of capital is that there shall be no profits arising from the handling of capital; so no one can be privileged to handle the capital and earn profits except by the direction of the state.

In a way, the arrangement sounds ideal; for everyone will do the thing for which he is best suited, will be assigned to work and therefore need not worry about a career, the state will provide all the necessary capital and education, and everyone will be assured of a comfortable living.

§ 344. **What is the State?**—This leads to consideration of another phase of the scheme The state, though a very powerful thing, does not exist entirely independent of human beings. The state cannot run itself, for it is not a thing in itself; it is a method of administration through human beings. Under the present system of so-called "Capitalism" there are many people who try to take advantage of their neighbors—particularly of those people who are not their neighbors and whom therefore they do not think of,—because human nature is not such that people can ordinarily be trusted to take care of other people better than those other people can take care of themselves. It chances, too, that other people

besides capitalists take advantage over others. The people who pay wages are often themselves wage earners, and they are sometimes treated unfairly by other wage earners as well as by capitalists; for sometimes a wage earner working for another wage earner gives short hours and inefficient work while he nevertheless draws full pay. Often, too, the wage earner gives the capitalist a smaller return in inefficient work than he has agreed to give.

Thus some capitalists and laborers reap where they have not sown; yet many, both of capitalists and laborers, refuse to take unfair advantage. We have both the sheep and the goats in both camps. Unfair advantage, however, can spring from only one condition; power. The complaint against capitalism is that capitalism has too much power. Yet the power of capitalism is infinitesimal in comparison with the power of the state if the state is given control of all the capital in addition to all its present prerogatives. Who administers the state? Men and women. What reason have we to believe that the persons who administer the state under state control of capital and industry will be any more conscientious, any more efficient, any more wise, than the people who now administer the affairs of capitalism?

§ 345. His Brother's Keeper.—But suppose they should prove more just and wise and efficient! Does that mean more justice and wisdom and efficiency than at present? A man who is just and efficient and wise in a small enterprise may find himself beyond his capacity in a large one. Under state control of capital and industry, all men are necessarily economic slaves of the state. One's education must

be chosen by the state, for the state must choose who are to serve it in different capacities, else the jobs may not be filled. One's residence must be chosen by the state, else the work may not get done. One's occupation must be chosen by the state, for there is no employer but the state. No alternative is left; for no one can have an income except from the state. And who does the choosing for the state? Men and women quite as subject to temptation, quite as inefficient, quite as lacking in wisdom, as the managers of capital. What man or woman is fit to be placed in such a position of power over his fellows as to prescribe his education, his residence, his occupation? Any honest person would pray to be delivered from such responsibility over the lives of men and women, youths and maidens; and yet under state control of industry and enterprise thousands of such absolute directors of other people's affairs would be needed in every large community.

§ 346. **The "Slavery" To Capital.**—It is well known that business cannot be carried on by committees: committees can pass laws and make decisions, but the carrying out of those decisions must be done by single individuals. There may be appeals and reversals, but there will be no getting out of the system of individual control. Whatever a man's wishes or ambitions or hopes, whatever his effort and accomplishment in fitting himself for something else, whatever his thrift, he cannot escape from his particular assignment to work unless he can convince his administrative superior that he had better be shifted. He cannot escape, for there is nowhere else to go. He cannot work without capital; and yet he is

forbidden to obtain or use capital except on orders of those administering state capital. There is much talk nowadays of the slavery of workers to capitalists; but only under rare circumstances is any particular employe dependent upon any particular employer or group of employers. Yet under state operation of industry every human being will be absolutely under the control of other human beings who happen to be chosen for administration. This would not be the exceptional case as it now is: it would be the very essence of the system. This is for everyone nearer slavery than anything now existing in any civilized country even in the worst case of control of the less fortunate by the more fortunate. So far as industry is concerned, it is absolute slavery.

§ 347. **The Effect of Slavery.**—Every student of history knows something of the effect of slavery. Slaves become shiftless, irresponsible, lazy. A nation in which men have no freedom of choice, no possible satisfaction of ambition except on the approval of an inescapable superior, no hope of establishing a "fixture" that is subject to their own control only, is doomed, for the springs of energy are destroyed. A man may struggle and work for another, a loved one or even a stranger; but he will not do so when he fears that the fruit of his labor will be taken from him or will be squandered through wastefulness. Even the administrators, moreover, will have little incentive to be efficient.

All this means that under such a system of production wealth will heavily decline. When wealth is declining, none can get more wealthy. Even though

a redistribution may take from some and give to others, the gain to the new owner cannot last long; for wealth is perishable. Little of our total wealth persists year after year; it is recreated year by year —new crops from the seed of the old, new machines to take the place of the old worn out, new goods to take the place of old consumed in work and play. Unless the people work to recreate wealth annually, all will be poor together. Anything which destroys the motive to industry makes people poor, even if they should seize the wealth of the well-to-do, and actually leaves them poorer in the end than if they had not seized property but had continued to recreate wealth. The limit to all wealth is the production of wealth and both rich and poor are soon reduced to extreme poverty if wealth is not recreated constantly.

§ 348. The Weakness of Capitalism.—No one pretends that our present system is working properly or that it is in itself perfect. Like a system of state control, it must be administered by fallible human beings. It is based, however, on recognition of the fact that capital is necessary to modern production, that compensation for the use of capital is the best assurance that capital will be provided, and that all men should be given the opportunity to own and control capital and to dispose of their faculties in the best market. Where the present system of private control breaks down is in exceptional circumstances of sickness, of ignorance, of tragic handicap.

§ 349. Extraordinary Profits.—The present system is sometimes thought to have broken down when

it has not, for often injustice is thought to be where it is not. Sometimes, for example, the income from capital is much larger than is necessary to stimulate the accumulation of capital, and much larger than normal, and injustice appears to lie there. It is equally true that sometimes labor (mental or manual) appears to receive much more than enough to maintain it in every comfort and privilege while other labor is in straits. Usually, however, such conditions are both extraordinary and unavoidable (unless, indeed, freedom is to be destroyed). We have already seen that great managerial ability brings high salaries because such ability is scarce and highly productive. Managerial ability of some sort, good or mediocre, is needed almost everywhere, and even lowest pay for managers must be enough to attract the last men needed to get the managerial work done. If a man is better than the poorest grade required, he can get a better salary largely proportioned to the superiority of his productive capacity. So the salary is extraordinary when the ability is extraordinary.

Similarly, when the community needs certain goods it must pay a price high enough to bring forth the goods it will pay for. If what it needs cannot be produced by the most efficient firms, prices must go high enough to induce less efficient firms to turn to that production. The less efficient firms will get normal profits, and this leaves for the more efficient firms profits larger than normal—for there cannot normally be different prices in the same market. If there were to be different prices, who should decide which people should buy at one price and which at another? These

extra profits are not exploitation of the people; what has happened is simply that what is one man's necessary price leaves a margin for another; and that margin is reward of efficiency, like the reward of the able manager. The possibility of it is one of the inducements to efficiency, and is one of the compensations for risk offsetting the losses when the chances of business go the other way. The only avoidance of this sort of possibility of extra profit is the sort of governmental direction just discussed—in which a small part of the community has absolute economic control of the rest, and the rest are in effect economic slaves.

§ 350. **Expenditures Of The Rich.**—The common notion that these extra incomes are consumed by those who in the first instance receive them needs examination. A study of the lives of the richest men shows that they actually consume little more wealth than the rest of us. They can eat little more (and the more expensive food that a few of them eat actually results in discomfort and disease, while most of them maintain simple tables); they cannot wear more without discomfort (and many of them prefer, and choose whenever they can do so without endangering their business influence, the simple easy clothing of the workingman's type); and much of the balance of their expenditures is less for personal satisfaction than for acquiescence in custom. The fine estate that a rich man owns can gratify him usually in but few ways: so far as the gratification is from pride, it is short-lived, for pride is never satisfied; and so far as it is from visual enjoyment of its beauty, he has no monopoly, for often the poor man trudging to his work gets more satisfaction from the rich man's

lawns and flowers and trees than the man who pays for it.

The rest of the large income of the rich man is usually saved and becomes capital—furnishing the means by which the railroads, the factories, and the municipalities employ labor and make things for us all; and this is as it would be under governmental control of capital, except that usually the man who has been interested to save capital is a better judge of its wise use than a man chosen politically as an administrator for capital in which he has no interest. Usually, too, the man of large income has large responsibilities that leave him few hours with free and easy mind for either idling or personal consumption of wealth. There are few "idle rich." The man of large responsibilities thinks of a forty-hour week as a vacation. Often when he seems to be idling he is hardest at work, solving knotty problems, feeling large property interests and large human interests at stake, and knowing that he must not err. The really idle rich, on the other hand, like the idle poor, have no excuse for existence. Continued idleness should be made impossible for them.

§ 351. **The Way of Freemen.**—The effort to make impossible economic injustice and handicap is now occupying many of the fairest-minded and wisest men and women of the country. Many of them are capitalists or representatives of capital, and these are mostly also workers, hard workers, on salaries; many of them are primarily workers, and these are also most all capitalists—owners of homes, of bank deposits, of insurance policies, of stocks, of bonds;

many of them are not directly connected with either capital or labor primarily as capitalists or wage earners, but are professional men who are both capitalists (because of their savings from hard earnings) and workers (whose hours of activity know no schedule except the call of duty, whether those hours be forty or seventy). They are trying to find a way to stop the exploiting, to give the worker all he can produce (without working so hard as to sacrifice what is worth while in life), to insure the right to control what one has earned, and at the same time to maintain one's right to freedom—without interference by tragic circumstance, by personal whim or malice, or by unnecessary governmental direction. They believe that this is more easily possible under a system which retains individual right to save, to use one's own capital, and to control one's own capital, than under a system of governmental control of capital and labor administered by fallible men and women exercising well-nigh unlimited power over their fellow men and women. This is the very spirit of Americanism, or the rule of all the people, while the other is the spirit of oligarchy, or the rule of a few.

Note.—The author of the foregoing is a worker and not a capitalist, and it is as a worker that he desires to preserve the right of private capital. He has saved out of his hard-won earnings, but his savings have gone into home and land and books and education and insurance for his family. He believes that he has a better right than anyone else to determine what occupation on his part, what choice of residence, what care of the land about his home, what higher education for his children, what protection for the future, are best adapted to the ultimate welfare of his family. His right to the occupation, the residence, the land, education, the protection, on the other hand, must lie in his having earned and saved them,—or might lie in another's having earned them voluntarily for him. He believes that if he should choose from now on to devote his savings to the accumulation of funds for assistance in manufacturing goods, or in distributing goods

by sale, or in rendering public service, to forbid him to save and so to use what he had saved, and to forbid him to allow someone else to use his savings, and to forbid him to demand and collect compensation from anyone so using his savings, would be a fundamental violation of his rights as a man. He would resist to the utmost any attempt to interfere with those rights.

Questions for Review, Chapter XV.

1. What is the true economic view of a capitalist?

2. How are the savings of the people employed in the enterprises of capital?

3. As the product of labor, what does the existence of capital prove?

4. Is it possible for a community to get along without capital?

5. What effect does the possession of capital have in wartime?

6. What effect does the use of insurance premiums as industrial capital have upon the insured?

7. How does the use of savings deposits as capital benefit the depositor?

8. Who are the principal owners of the capital of the country?

9. Why does the control of capital fall into the hands of comparatively few men?

10. Why would State control of capital destroy the incentive to thrift and saving?

11. Show how State control of capital would involve State control of the workers and result in conscription of labor.

12. How does the human element enter into all State control, and dominate it?

13. Show how the destruction of the motive to industry, with State control of capital, would leave the people poorer in the end.

14. What are the chief weaknesses of the system of private control of capital?

15. What are the economic effects of the possibility of extraordinary profits? Is this possibility a danger to the community?

16. How is the large income of the rich man generally used?

17. Why does the system of private capital embody the spirit of Americanism?

CHAPTER XVI

Investments

Note.—In this chapter a noted Chicago banker discusses a subject of importance to every student of business. The text originated in the form of a lecture to the students of the University of Chicago. The author, Mr. David R. Forgan, is president of the National City Bank of Chicago. The figures which he gives refer to a period prior to the World War.—Editor.

Section 352. Meaning of Investment.—There is a sense in which all business enterprises are investments. To build a ship or a railroad, to start a store or factory, to pay wages or place an advertisement—to do anything, in short, which involves an outlay of money for the purpose of increasing it—is an investment of capital. That is the sense in which political economists use the word, but in common use it has a more restricted meaning, namely, the outlay of money in the purchase of property or securities which are expected to yield a sure and regular income without further effort on the part of the investor. This discussion will be limited to what may be included in that definition.

At the outset it may be well to have a clear view as to what funds are available for an investment; or to answer the question so often asked as to where all the money comes from to pay for the enormous issues of securities which are constantly being brought out.

A writer on this subject begins with the statement that the bank deposits of the United States increased in seven years by $4,000,000,000, and that "the effort to place this enormous amount of new capital disorganized the entire field of investment." This is not correct. If the author had looked deeper, he would have seen that the increase in loans had kept pace with the increase of deposits, and that the banks had no greater percentage of reserves than before. In fact, about the time this statement appeared the banks in New York were under their legal reserves, and money was bringing good rates all over the country because it was scarce. Only such portion of the increase of deposits as represented the savings of the masses, or the surplus earnings of commercial enterprises, was available for investment. The remainder, which constituted by far the larger part of the deposits, represented only expansion of credit, and was not available for permanent investment.

§ 353. **Bank Deposits are Largely Credits.**—It is a common error to consider bank deposits as "money in the bank," whereas they are largely composed of credits on a ledger. When a banker lends a customer $100,000 he takes the customer's note and credits the customer's account with the proceeds. The transaction increases both the deposits and loans by $100,000, but adds nothing to the "money in the bank." Even when the customer draws his checks upon the credit, it does not necessarily follow that the money in the bank is reduced, for his checks either go to the credit of another customer of the bank or they find their way into another bank and are offset by similar transactions in that bank.

This credit of $100,000 created by the banker discounting the note of his customer performs all that actual money can perform, and practically adds that amount to the resources of the business community while it is extant. If the credit has been wisely granted, the note will be paid when due by the customer accumulating enough credit balance in his bank account and then giving his check for his note. The transaction will reduce the bank's assets and deposits by $100,000; but it will not increase nor diminish the "money in the bank."

§ 354. Little Actual Cash Demanded.—In only a small portion of the transactions thus accomplished by credit will actual cash be demanded, and against this the banker must keep a certain percentage of his deposits in cash reserves. If the credit be granted to a worthless customer who cannot retire it when due, then the bank loses the amount, because its resources are reduced by $100,000 while its liabilities remain the same. Right there in the difference between redeemable and irredeemable credit lies all the difference between good banking and bad banking, good currency and bad currency, good investment securities and bad investment securities.

Thus the increase of bank deposits was due more to the extension of credit than to an increase of actual money in the banks, or of funds looking for investment. In like manner, when deposits decrease it is a contraction of credit which takes place rather than a withdrawal of money.

In October, 1893, for example, there was more money in the national banks by $28,000,000 than

there was in 1892, yet the deposits were $500,000,000 less on account of the contraction of credit due to the panic—the loans and other credit assets being correspondingly reduced.

§ 355. **The Potency of Credit.**—In any financial discussion we shall soon go astray if we lose sight of the place and potency of credit. It is estimated that 90 per cent. of all business transactions are done on credit, and the currency used in the majority of cases composing the other 10 per cent. is only credit in another form. In credit modern finance lives, moves, and has its being. It is not merely the means by which you buy and buy and pay by-and-by.

It is difficult to define, but we may say credit is the medium through which the representatives of property or value may be exchanged. The bank customer's note is in one sense only a slip of paper, but it represents all the property owned by the makers. In the same way bonds represent the property they are based upon; certificates of stock represent the capital of the company which issues them, and bank deposits stand for actual cash. Credit rests on confidence, which is simply a reflection of the existing conditions. When confidence prevails, credit expands easily—that is, the representatives of property and cash are readily interchanged. When confidence is shaken, credit contracts in proportion to the gravity of the cause, and interchange becomes correspondingly difficult. If confidence be destroyed, there is a panic, when it is almost impossible for the bank customer to negotiate his note, the railroad to sell its bonds, or the industrial company to float its

stock. And all this happens while the money in circulation is little, if any, reduced.

§ 356. **Recent Expansion of Credit.**—The past few years have witnessed a remarkable expansion of credit in this country. The bank deposits increased about $3,500,000,000, and new stocks and bonds issued during the period probably reached a total of $10,000,000,000, while the total money in the country, paper and metallic, increased only about $500,000,000. In other words, for every dollar in money added to the general stock, bank deposits increased $7 and securities $20. It is not necessary, therefore, that money be available to absorb a new issue of securities. If there is room for them in this sea of credit, they may be launched and floated.

When a new issue of investment securities is made, it is generally set afloat as collateral to an expansion of credit by the banks which extend to the broker or bond dealer credit with which to carry the securities until a market is found for them among investors. The rapidity with which investors will absorb them, and the price paid for them, depend upon their desirability and the condition of the money market —or, more correctly, of the credit market.

§ 357. **Effect of Public Confidence.**—If confidence abounds, people readily invest in the representatives of property—stocks and bonds—and this creates a strong demand and a high price. On the other hand, if confidence be shaken, people prefer cash or its representative—bank balances—of certain value to securities of uncertain value, and they are slow to convert the former into the latter; and

thus the demand is less than the supply, and the price obtained is consequently lessened.

When conditions are panicky, new issues of securities cannot be sold at all, and the holders of old issues become so anxious to convert them into bank balances of stable value that prices fall far below intrinsic value, and then it is "bargain day" in the credit world. Many rich men hold their reserves for such occasions, which constantly recur, and they grow richer by so doing.

§ 358. **Funds Available for Investment.**—The funds available for investment, which gradually absorb securities, come chiefly from the following sources, the first two of which have already been suggested:

(a) Savings banks deposits—representing, not an expansion of commercial credit, but the savings of the common people.

(b) That portion of the deposits of commercial banks which represents the accumulation of the profits of business and which may be withdrawn from business.

(c) The funds of life and fire-insurance companies.

(d) The funds of educational, charitable, and benevolent institutions.

(e) The funds of estates in cases where the executors decide to exchange the assets at risk of general business for permanent investments, which call for no business management on the part of the owner.

(f) The funds of retired business men who follow the same course for similar reasons.

(g) The investment accounts of commercial banks maintained for the purpose of having some assets which can be converted into cash immediately in case of need

(h) That portion of the increment derived from former investments which the holders do not spend.

§ 359. Increase of Investment Securities.—In such good times as we had for several years prior to 1914, the combined demand from all these sources was enormous; hence both the rise in the price of securities and the rush to create and float new issues which we witnessed during that period.

We have no statistics which present a complete account of the increase in the supply of investment securities in the United States during the period named. Some idea, however, may be obtained from the amount of bonds and stocks listed on the New York Stock Exchange, although these are but a small portion of the whole. During a period of five years there were listed $949,516,639 bonds and $1,443,850,-208 stocks, exclusive of those which merely replaced old securities. In addition to these, every village, town, city, county, and state in the country has its own local securities. New issues are also constantly being created by new inventions, such as the telephone, the bicycle, the automobile, etc., so that the estimate of a total of $10,000,000,000 of new securities issued during these five years is probably not far astray.

Yet no question is more frequently asked than

this: "Where can I find a safe investment which will yield a fair rate of interest?" And perhaps no question is more difficult to answer.

§ 360. **What Constitutes Desirability.**—A man of little experience and superficial knowledge may answer readily enough, but the answer will come slowly from a man of conservative judgment. The desirability of any investment consists of three attributes: (1) Safety, (2) Profit, (3) Permanency. All three, however, are relative terms. In investments there is no such thing as absolute safety, assured profit, or unchangeable conditions. United States bonds are today among the highest-class investments in the world; yet men are still living who saw them go to a discount of 78 cents on the dollar. Within a few years their profitableness was reduced by half, and before the World War the indications were that they would all be paid off within our own day. (All we can do, therefore, is to consider the relative safety, profitableness, and permanency of the different classes of investment. There are investments which are more safe than profitable; others which are profitable, but not safe; and many which are neither safe nor profitable, but are certainly permanent.

We shall now consider the different kinds of investments offered in the United States, grouped as far as possible under four divisions.

I. Public Securities

§ 361. **Government Bonds.**—At the head of this class stand Government bonds. These are held chiefly by national banks as security for their cir-

culation, or for government deposits, and by trustees for funds in cases where safety is a more important consideration than profit. They are as safe as anything on earth and always marketable, but they scarcely call for our consideration, because they no longer offer any attraction to ordinary investors.

One of the striking marks of our national prosperity is the fact that American investors have often been offered and have readily accepted participation in loans to foreign countries. Russian government bonds issued in connection with their great railway a few years ago were taken at a price yielding $4\frac{1}{8}$ to the investor; the German loan of 1901, $3\frac{3}{8}$; the English short time loan of 1900, 3.4; and the English irredeemable consols issued in 1902, about 2.6 per cent.

§ 362. State Bonds.—Next in order come State bonds. Their history is not one of the things we are proud of. A total of over $300,000,000 (principal and interest) of them is now delinquent by reason of repudiation on the part of their makers. A large part of this delinquency is made up of what is known as "carpet-bag" bonds issued by Southern states during the period of reconstruction and later repudiated on the ground that the government creating them did not properly represent the people. But that is not true at all. Virginia, for example, has old bonds outstanding which were created before the war and which you can buy for a few cents on the dollar. This is possible because the Eleventh amendment to the Constitution took away the right of private parties to sue States for payment of their debts.

It is probable that the days of repudiation are

past, but history sometimes repeats itself, and it is well for the purchaser of state obligations to remember that their payment depends entirely upon public morality. If he confines himself, however, to the bonds of states whose good financial reputation is necessary to the business interests of their citizens, the risk of loss which is inherent in all investments will be reduced to a minimum.

§ 363. **Municipal Bonds.**—What has just been said regarding State obligations applies with equal force to the obligations of municipalities. There has been much repudiation also on their part, but most of it has been of bonds for which the people of the municipalities never received any consideration, the bonds having been issued during the speculative period succeeding the war in support of railroad schemes.

Unlike States, municipalities can be forced to pay through the courts, and so numerous have such cases been that almost every point concerning the legality of municipal obligations has been finally decided by the courts. The opinion of a competent lawyer as to their validity is now enough to satisfy investors, and such an opinion is always offered by bond dealers when offering the bonds. Beyond that it is only necessary to ascertain the population, and the general prosperity of the municipality, and the relation these bear to its total indebtedness, in order to decide upon the desirability of its obligations as an investment.

In many States the legal limit of such indebtedness is only 5 per cent of the assessed value of the property within the municipality, and this is perhaps

only 1 per cent of the real value. With this safeguard, with our population increasing at the rate of 4,000 per day, and with the prevailing prosperity of our country, municipal obligations are now very popular investments. They yield, according to their grade, from 3/5 to 5 per cent to the investor, and as a class they are one of the best investments in the market.

II. Real Estate Securities.

§ 364. **Speculation and Investment.**—The purchase of real estate itself may be considered as an investment if it is already improved and yields an income, or if the purchaser improves it immediately after its purchase. To buy unimproved real estate simply with the hope that it will increase in value in the future, is a speculation, not an investment.

Among men who have been successful in a small way the purchase of unimproved real estate is at times quite popular. The idea seems to be inherited that to own a piece of property is a mark of respectability and substance. The thought that it cannot run away or disappear seems to make it safe, and there is always the hope that it will increase in value. Nothing, however, could be more delusive. In ninety-nine cases out of a hundred it would pay better to put the money in a savings bank at 3 per cent interest.

Even improved property is usually unsatisfactory as an investment. When taxes, depreciation by use and by change of style, repairs, insurance, periods of vacancy, and failure to collect rents are taken into

account, the owners of real estate are generally disappointed in the net results. There are many notable exceptions, of course, but to own much real estate and get little out of it is so common that the term "real estate poor" has come to be quite well understood among business men. The safest way to invest money in real estate is to buy it and lease it to others to build upon. In good localities the ground rent is assured by this means, and this makes one of the safest investments known. There is not enough of such business, however, to make it generally available.

§ 365. **Mortgages.**—Another way to invest money in real estate is to advance it on mortgages, with a margin which should not be less than 50 per cent. Even then you are not sure that you will not have to foreclose your mortgage and take the property. A fall of 50 per cent in the estimated value of real estate during the currency of a mortgage even in growing and prosperous communities is by no means uncommon. The value of real estate is never more than an estimate—an opinion—in which it is always difficult to find two authorities who agree. There is nothing wilder or more extravagant than the ideas of otherwise sensible men on the value of real estate during a period of inflation.

A case in Minneapolis will serve as an illustration. A man after successful litigation became the owner of a tract of land near that prosperous city, valued in popular opinion at a million dollars. He became involved in debt to the extent of $250,000 and mortgaged all his real estate for the benefit of his

creditors. The mortgage was foreclosed for the various creditors by the leading lawyers of the city—one of the ablest all-round business men—who thus became thoroughly familiar with the property. A bank was one of the creditors, and the lawyer informed the bank that the claim was quite good because the debtor would be certain to redeem the property from the foreclosure. It was not redeemed, however, and the bank had to arrange a division of the property among the creditors. For that purpose another valuation was made of the various lots, which amounted in all to about $70,000. On that basis the million-dollar property was divided, the best cash offer the bank could get being about two-thirds of that amount. In other words, the value of a tract of land contiguous to a thriving city of (then) 160,000 inhabitants shrank in popular estimation in a few years from $1,000,000 to less than $50,000.

Anyone wishing to invest his money in a real-estate mortgage should make sure that he is getting a first mortgage. There is nothing on the face of a mortgage or trust deed in Illinios and some other states to show whether a prior lien exists, and the palming off of a second or third mortgage as a first is not an unknown trick. He should also be satisfied that the title is clear in the name of the mortgagor. This is usually evidenced by a title guarantee policy, which is sufficient in most cases, though by no means infallible.

Then he should insist on seeing the property with his own eyes. No matter how reliable the mortgage dealer may be, a purchaser may, by visiting the

property, discover something which may save him from an unsafe, or at least a slow and unsatisfactory, investment. It is not impossible that he may discover that the building shown to him by the mortgage broker as on the property is as yet far from completed, and that only part of the money represented by the mortgage has been paid to the mortgagor, the balance being represented by a credit on the books of the broker which is to be exhausted as the building goes on. In this case the investor must trust to the broker to see that the building is completed free of mechanic's liens and fit for occupancy.

Whether it is safe to trust the broker depends upon his financial and moral standing—which opens up a new field of investigation for the investor. He should also inquire into the financial standing of the mortgagor. If that be unsatisfactory, the payment of interest is likely to be irregular, and foreclosure may become necessary on account of the mortgagor's difficulties, although the property itself may be quite good for the amount involved. Foreclosure is a slow, tedious, and expensive way of getting money back, even if it does get it back.

§ 366. Building and Loan Associations.—One of the worst forms of investment in real estate in the opinion of many bankers, is building and loan associations. They are gotten up in most attractive forms to catch the monthly savings of thrifty people with moderate incomes. True, there are some of these in the older parts of the country that are apparently successful, but experience of them in the West leads one to consider them as, on the whole, almost the easiest concerns to get your money into and the hard-

est to get it out of that you can find. Their plans seem so simple that anyone can understand them; nevertheless, a Chicago man who is a thorough accountant, lost the savings of years in a building and loan association of which he himself was the annual auditor.

§ 367. **Farm Mortgages.**—On the other hand, farm mortgage are one of the best real-estate investments. Swindlers have not been unknown along this line, but the results to investors have been as satisfactory as in any line of investments. As in all others, prudence and common-sense must be exercised; but there are many corporations and firms of high standing engaged in the farm-mortgage business, and by dealing only with such, and avoiding certain states where the laws seem to have been made for the debtors, a safe and fairly remunerative investment in farm mortgages is easily obtained. On the whole, investors should remember that to invest safely and satisfactorily in real-estate securities requires more knowledge of business, more experience, and better judgment than to invest in almost anything else.

III.—Corporation Bonds.

§ 368. **Railroad Bonds.**—Under this head come, first, railroad bonds, which have absorbed more capital than any other investment in this country. A few years ago there were 187,781 miles of railroad in operation, the bonds on which amounted to $5,699,-858,000, or $30,000 per mile. The interest paid on the bonds was $245,250,000 or 4.12 per cent. This great class of investment securities is composed of

various kinds. We have not only first, second, and third mortgage bonds, but consolidated mortgage bonds, income bonds, convertible bonds, terminal bonds, collateral trust bonds, equipment bonds, etc.

Among such a mass and variety as I have mentioned there are many of inferior quality, and some of even worthless character. The chief guide for the investor is in the earning capacity of the road, and reliable information on that point is easy to obtain. If the road's net earnings are at least twice its bonded debt charges, and if the road is well kept up so that such earnings are likely to continue, the bond may be considered satisfactory in that respect.

There is no difficulty in procuring good railroad bonds as an investment, if the investor confines himself to the issues of well-established roads, and is content with a return of 4 per cent or a little less. It is when the bonds of new railway projects are offered that caution is necessary.

It is a well-recognized principle in railway building that the road should be made not only to pay for its cost, but to yield a profit to the projectors besides. In other words, there is usually some "water" in the first issue of bonds—to say nothing of the stock. The squeezing out of the water in times past has frequently been an expensive operation for the bond holders. The appointment of a receiver, the discrediting of the securities, the purchase of them by "insiders" at a heavy discount, the "reorganization" of the road, or the sale of it to a large system, and the final happy outcome for said "insiders," is a process with which the student of railroad history is familiar.

Nor have cases of actual fraud in this line of operation been wanting. Sometimes they break ground for a railroad with great ceremony. Then they proceed to break the shareholders without any ceremony.

A railway campaign in Arkansas built only forty-eight miles of its projected road, but its promoters succeeded in floating $5,000,000 in bonds of one kind or another on it. The road was so poorly built (what there was of it) that it was almost worthless. When it was sold by the receiver at public auction, it brought the sum of $40,000, and even that was paid to the receiver in his own receiver's certificates, which had been bought at a discount. Such cases sufficiently illustrate the kind of dangers to be avoided in this class of securities. Our railroads at present, however, are in better condition than ever before. As a rule, they are properties of enormous value and productive power, and no better securities, as a whole, can be had than properly selected railroad bonds.

§ 369. **Public Utility Bonds.**—Another large and rapidly growing class of bonds is composed of the issues of corporations operating public utilities, such as street railways, telephones, gas and electric-light plants, etc. Those offered in the market, however, are frequently new and based on properties in course of construction. They are disposed of on "estimated" earnings and well-written prospectuses. In such cases investors should never forget that, as a rule, all the risk of the enterprise is put upon the bond buyers. If it turns out a success, their investment will be good and they will get their 5 per cent, per

annum. All the rest of the "estimated" profits that illumine the pages of the prospectus—be they ever so large—will go to the promoters of the scheme, who, as a rule, have put in no money of their own.

If it turns out a failure, the bondholders will be the only losers. This division of profit and risk does not seem quite equitable, but it is astonishing how ready many people are to accept it. The moral is plain: Never invest your money in the bonds of any such enterprise until it is completed and can show actual net earnings of not less than twice the amount required to pay the interest on its bonds.

Many of these enterprises are legitimate and profitable, and offer good securities for their bonds. But it is time enough to buy the securities after their safety has been demonstrated by actual experience. This is a good rule, indeed, in regard to any investment.

§ 370. **Waterworks Bonds.**—There is another class of bonds somewhat similar to those last mentioned—waterworks bonds. The provision of law, before alluded to, limiting the borrowing power of municipalities to 5 per cent of their assessed property value, prevents many towns from owning their own waterworks. The plan usually adopted is to form a corporation to which an exclusive franchise is granted to build waterworks. A contract is then entered into between the municipality and the water company, by which the latter undertakes to supply the former with a certain number of hydrants for fire protection, etc., for a certain sum per annum. This annual payment is then used to form a sinking fund

for the retirement of the bonds issued to cover the cost of the waterworks. The company has also the right to sell water to the inhabitants, and the enterprise is frequently a profitable one, forming a safe basis for the issue of bonds. As usual, however, there are numerous dangers to be avoided, and possible losses to be feared.

One of these is that the water supply may not prove sufficient. Another is that the construction of the works may be cheap and not last as long as the life of the bonds. Still another danger is that the municipality cannot be bound by its contract longer than the life of the council which made it. A succeeding council may reduce the price paid for the hydrants. The greatest danger of all is that the company may get into a fight with the city; that the citizens may claim that the water is impure, and that as a result the waterworks may be abandoned and another water supply adopted. In Duluth such a fight was brought about by an epidemic of typhoid fever. When the fight began, the water company's bonds were considered a first-class investment, and its stock was very valuable. When it ended, the bondholders got seventy cents on the dollar and the stockholders nothing.

We might go on discussing miscellaneous bonds, but it is not necessary. Enough has been said to indicate the dangers to be guarded against, and to show that careful investigation before buying is a necessity; for while there are good, safe investments offered in all classes of bonds, it is easy to lose money.

IV.—Stocks.

§ 371. **Bonds and Stocks.**—The great difference between bonds and stocks is that, while the former are a lien on property of one kind or another, the latter frequently represent nothing more tangible than earning capacity, good-will, and the hope of the future. These are sometimes assets of great, but always uncertain, value. As a rule, it is the hope of a rise in value which leads investors to purchase stocks, and this brings a speculative element into the transaction. Of course, stocks are not all equally speculative. Bank stocks, for example, with their sworn, published statements, and the safeguard of government inspection, are not to be classed with mining stocks, about which nothing published is ever true, and of which no inspection is ever disinterested.

Another vital difference between bonds and stocks is that the former is a promise to pay both principal and interest, which can be enforced by law, whereas stock promises nothing. In other words, the holder of a bond becomes a creditor of the makers of the bond, whereas the holder of stock becomes a part of the company issuing it, and to that extent a debtor for all the liabilities of the company. In some cases (notably in bank stocks) the holder of the stock is liable for as much again as the face amount of the stock.

§ 372. **Railway Stocks.**—Among stocks railways form the largest and most popular class. The total amount of them is slightly greater than that of railroad bonds, namely $5,742,000,000 in a recent year,

while the dividends paid amounted to $109,000,000, or 1.90 per cent. In such a vast total there is, of course, great variety, grading all the way from first-class to worthless. Most of them are listed on the New York Stock Exchange—a fact which has both advantages and disadvantages from an investment standpoint. The chief advantage is that they can be readily sold, but this is outweighed by the fact that they can be as readily manipulated for stock jobbing purposes. As a class, they cannot be recommended to investors who desire something that they can "go to sleep on." They require constant and intelligent watching, and only those who are capable of giving that to them should put their money into them.

§ 373. **Industrial and "Trust" Stocks.**—Another large class of stocks which has come into special prominence in the last few years is that known as industrials, which are chiefly the preferred and common stocks of the large corporations commonly called "trusts." The extravagant way in which most of these combinations have been capitalized has filled many conservative minds with vague forebodings of coming disaster—moral, financial, and national—as the final outcome of the movement. But we should not confound the manner of doing a thing with the thing itself. We may admit that the promoter's profit has been the chief motive in most of the combinations, that capitalization has been extravagant, that speculation has been overstimulated, and that great danger exists in the fact that the caution which should control the investor has already given place to the craze for large and quick returns. But the movement itself will outlive these accom-

paniments, if it is economically sound, and if it leads to the greater and easier production of wealth.

The so-called trusts are probably here to stay. The college presidents may rage and the politicians imagine a vain thing, but no law can be formed which will make it a crime for any number of people to combine their capital and ability in any legitimate business. Laws have been and should be enacted for the regulation of the combinations, for greater safeguards to the investing public, and for the protection of competing smaller concerns against monopoly.

Compulsory publicity of the condition of the corporations will go a long way in the right direction; but all talk of stopping the movement is vain. It is clearly an economical evolution from the evils of excessive competition, and much can be said in its favor. Its tendency is toward economy of production by the saving of all wasteful and unnecessary expense; and this is in harmony with the spirit of the age, which is ever improving on old methods and machinery. Its tendency is always toward a larger ownership of the property represented by the corporation and a wider distribution of the profits. There are now thousands of owners where there were but hundreds.

Competition is now between nations as well as individuals. Consolidations have had their share in placing this country at least a neck ahead of our greatest competitors in the international race. How they are affected by hard times was seen in the depression of 1907-08. A few great vessels will always weather a storm better than many small craft.

When great changes are going on it is natural to have some apprehension as to final results and easy to prophesy evil. When Rowland Hill's penny post scheme had gained such support as to have its adoption proposed in Parliament, Sir Robert Peel, the greatest financial minister of his day, was its strongest opponent, and prophesied nothing but loss and failure as results. All the great movements in history were fiercely opposed by some of the ablest men of the time who were specialists on the particular matter in question. Looking back now, their opposition seems absurd. And so when our theoretical economists predict disaster from this movement, we must wait and see. None of the calamities has happened yet.

A great railroad resembles a modern trust in many respects. It is generally controlled by one man, but owned by thousands. It pays its stockholders better, serves the public better, advances national development better, and makes transportation vastly cheaper than a hundred small roads could do. In fact, the industries now being combined into large corporations are only following the example of the railroads. Of course, there is always the danger that things will be overdone and tendencies carried too far. But against this there is an intelligent public sentiment which will have to be reckoned with. The so-called trusts will no doubt live; but they will live only by proving that their existence is a benefit to the people and not a curse. This they will probably be able and wise enough to do.

The field for investment known as "industrials," therefore, should not be passed by with a timid epi-

gram, but is fairly entitled to consideration. Here, even more than elsewhere, investigation of the facts, guided by common-sense, is a necessity. The common stocks composed entirely of water and given away as a bonus to help sell the preferred cannot be classed as investments and many of these preferred stocks represent such extravagant capitalization that they also should be avoided. But for investors capable of intelligent investigation before, and supervision after, purchasing their investments some of the preferred industrials offer a legitimate and profitable opportunity.

Take the case of a large company whose products are used in every household of the land. It is provided with sufficient working capital so that it is never a borrower, and it has no bonds, except a small amount existing on some of the plants before they were acquired, which cannot be paid until they mature. It has earned dividends on its preferred and common stock from the beginning, and is piling up a good reserve fund besides. It has a staple business and is excellently managed. One fails to see, therefore, why its preferred stock, or the preferred stock of any other "industrial" in like circumstances, is not a safe and legitimate investment for a business man capable of keeping an intelligent supervision of his affairs.

§ 374. **Miscellaneous Stocks.**—In addition to these great classes there are miscellaneous stocks too numerous to be here discussed. With regard to them as to all other securities, few general rules for insuring safety can be stated. The object in this discus-

sion has been simply to hint at the dangers to be avoided, and to suggest the lines of investigation to be followed in buying the common securities which our market offers.

§ 375. A Safe General Rule.—It may be said, however, that the safest general rule is to be content with a moderate rate of interest. From $3\frac{1}{2}$ to 5 per cent is all that can now be looked for in securities which will require no watching on the part of the holder. One per cent more return on an investment usually means at least 10 per cent more risk of losing the principal. The days of large returns on securities offered to the general public are over, and all flaming advertisements or well-written circulars which promise high rates of interest should be passed by as little better than frauds.

An investor should never allow himself to be hurried into buying anything on the ground that if he does not buy at once the opportunity will be gone. He should take time to see the property or to read the document. This may save him much time, worry, and loss. It is wise not to put too many eggs into one basket, and not to buy when everyone else seems to be buying the same thing. Above all, he should never expect something for nothing. Anything that can be got for nothing in the business world is pretty sure to be worth nothing, but to cost something in the end.

The rate of interest on investments has been steadily declining for many years, but is now probably as low at it is likely to go for many years to come. We are only beginning to realize the tremendous resources of our country, and until they have been

fully developed, capital will continue to bring fair returns.

Questions for Review, Chapter XVI.

1. Can all business enterprises be regarded as investments? If not, why not?

2. What is the more restricted meaning of investments in common use?

3. From what sources are funds obtained to pay for new issues of securities?

4. Can bank deposits properly be considered as "money in the bank"? If not, why not?

5. What percentage of all business transactions is done on credit?

6. How can credit be defined?

7. What has been the effect of the remarkable expansion of credit in the United States during the past few years?

8. Upon what does the price and salability of securities depend?

9. What is the general effect of public confidence on the stock and bond market?

10. Name some of the sources of funds available for investment.

11. What constitutes desirability in any investment?

12. Into how many divisions may the different kinds of investments offered in the United States be grouped?

13. How are government bonds chiefly held?

14. Upon what does the payment of state bonds depend?

15. Can states and municipalities be forced to pay their bonds through the courts?

16. What is the distinction between speculation and investment in the purchase of real estate?

17. Is improved property always satisfactory as an investment?

18. What should an investor in a real estate mortgage ascertain before parting with his money?

19. Are farm mortgages a desirable form of real estate investment?

20. What is the chief guide for an investor in railroad bonds?

21. What rule is it desirable to observe in regard to the purchase of public utility bonds?

22. What is the great difference between bonds and stocks?

CHAPTER XVII

The Stock Exchange.

Section 376. Economic Value.—The general public too often regard the stock exchange merely as a noisy congregation of brokers who gamble in the securities of government and corporations, under the guise of legitimate business. A deeper insight, however, into the character and functions of these institutions will show the important part which they play in the financial mechanism of the country.

The exchanges of the world are instruments of enormous economic value in subdividing and distributing capital and in directing its employment in great commercial and industrial enterprises. When the Wall street man goes down to his office his first inquiry is for the two-o'clock prices on the stock exchange of London, which are received before ten o'clock in New York. The quotations of American stocks, with the accompanying price of consols and the Bank of England rate give him the financial condition abroad translated into figures by the keenest financiers.

New York has no more entertaining public exhibition than its Stock Exchange. The visitor who, for the first time, looks down from a gallery upon

its members in the act of transacting business, is astonished at the turmoil and confusion he witnesses.

§ 377. **Business on the Exchange.**—There is no reason why bonds and shares should not be publicly dealt in, and in large quantities, as well as dry goods, corn, or cotton. But, unfortunately, few stock exchanges confine their transactions to ordinary legitimate business.

The members are divided into two classes—those who execute commission for others, and those who deal on their own account. Among the latter are the boldest and sharpest speculators of the day. You will look in vain in the quotations for the stock of dozens of corporations whose securities are among the choicest investments. It is upon fluctuations that stock speculation grows strong, and the largest profits are often made on the poorest stocks.

In London, Paris, Berlin, and New York there are very large private banking institutions which buy and sell bonds and stocks on the stock exchanges of the world on commission. These great financial institutions negotiate loans for governments and great corporations and are the intermediaries in all the great movements of capital from one country to another.

§ 378. **The London Exchange.**—The London Stock Exchange has scarcely more than one hundred years of history. In the early part of the 19th century the elder Rothschild was one of the giants "on' Change," and it was in this business that he amassed the great fortune which makes the name of his house synonymous with money power. The Exchange occupies an

old dingy building on Capel Court close to the Bank of England. The membership is not limited to a fixed number, as in Paris and New York.

One of the marked peculiarities of the Stock Exchange of London is the distinction between those who act as agents for the public, and who are properly called brokers, and those who do business on their own account and are described as dealers or jobbers. On the Paris Bourse all agents are strictly forbidden to trade on their own account. The New York members who operate on their own account are called room-traders or scalpers, whose profits or losses consist in quick turns made during the day. They endeavor to detect immediate monetary influences without considering the ultimate tendency of prices.

§ 379. **Listing of Stock.**—Nominally the stock exchanges guard the public interest in declining to admit to their regular quotations the stock of questionable enterprises. Before any shares, bonds, or debentures can be quoted in the official lists, application must be made in behalf of such issues and their bona fide character must be established.

The membership of the New York Exchange is limited to about 1,100 and seats becoming vacant by retiring members bring prices all the way from $20,000 to $75,000 each. Stocks and bonds sold in the regular way are deliverable to the buyer during exchange hours on the following day. Transactions are quickly collated and rapidly reported to the outside world.

In hundred of offices in New York City and in other American cities can be seen a little instrument called a ticker, which automatically prints abbreviated names of stocks, with their prices, on a narrow ribbon of paper. These tickers are rented to these offices, as are telephones, by the local telegraph companies, and as fast as the sales are made the quotations are ticked off in thousands of offices in all parts of the United States.

There are many exchange institutions in the country. Nearly every large city has its stock exchange, and scattered in trade centers are cotton exchanges, produce exchanges, petroleum exchanges, mining exchanges, etc.

The New York Curb Market, formerly doing business literally "on the Curb" in close proximity to the Stock Exchange, has recently (1921) moved indoors and now occupies a fine building on Broad street. Many stocks of value that are not listed on the Stock Exchange are traded in, and the Curb now lays claim to being America's second largest stock market.

§ 380. Technical Terms of Stock Exchanges.—The term "bull" is applied to those who are purchasers of stock for long account, with the purpose of advancing prices, as the tendency of a bull is to elevate everything within his reach. The term "bears" is applied to those who sell stock short, with the purpose of depreciating values. The bear operates for a decline in prices. To buy one stock and sell another with the expectation that the one bought will advance and the one sold will decline, is a "hedge." The

broker's charge for his services is called a commission, which in the New York Stock Exchange is one-eighth of one per cent each way on the par value of the security purchased or sold. A point means one per cent on the par value of a stock bond.

Stock privileges or puts and calls are extensively dealt in abroad and to some extent here. A "put" is an agreement in the form of a written or printed contract filled out to suit the case, whereby the signer of it agrees to accept upon one day's notice, except on the day of expiration, a certain number of shares of a given stock at a stipulated price. A "call" is the reverse of a put, giving its owner the right to demand the stock under the same conditions. A put may serve as an insurance to an investor against a radical decline in the value of stock he owns; a call may be purchased by a man whose property is not immediately available, but who may desire to be placed in a position to procure the shares at the call price, if they are not below that in the open market when he secures the necessary funds.

The speculator usually trades on margins. If he has $500 to invest he buys $5,000 worth of stock, his $500 being ten per cent of the total amount. He expects to sell again before the remaining amount falls due. The margin is usually placed by the speculator in the hands of a broker as a guaranty against loss. Although these brokers are really agents for others, yet on 'Change they stand in the mutual relationship of principals. A "margin" is merely a partial payment, but a broker buying stock for a client on margin is compelled to wholly pay for it. If he has

not the necessary capital his usual custom is to borrow from banks or money-lenders, pledging the stock as collateral security.

On foreign exchanges the element of credit enters more largely into the conduct of business. Where the credit of the client in London is established, his broker does not, ordinarily, call on him for any cash until the next "settlement day."

There are a variety of methods of securing what is called a corner, that is, a controlling interest in marketable stocks which others are compelled, owing to previously made contracts, to buy.

A "syndicate" is a party of capitalists who unite their resources to accomplish some financial object, such as the purchase of a property, a public loan, an issue of bonds or stocks, or any other undertaking requiring large capital.

A "pool" is in some respects similar to a syndicate. The funds of individuals are put into a common undertaking with a view of manipulating particular securities and dividing the profits. It savors of speculation if not of gambling.

A "boom" is an expansion of credit and a large inflation of value. A "panic" is an unusual fright among speculators which reduces prices and causes a general collapse of credit. A small boom is called a "flurry."

The rules of the exchanges of New York forbid trading after closing hours, but in times of great financial excitement business overflows into the streets and hotels and is called trading "on the

curb." A "wash sale" is a fictitious transaction made by two members acting in collusion, for the purpose of swelling the volume of apparent business in a security, and thus giving a false impression of its value.

Stocks sell "dividend-on" between the time the dividend is declared and the day the books of the company close for transfer; after that they sell ex-dividend, in which case the dividend does not go to the buyer. When a company decides not to declare a dividend it is said to "pass its dividend."

To sell stock "buyer 3" is to give the buyer the privilege of taking it on the day of purchase, or on any of the three following days, without interest; and to sell stock "seller 3" is to give the seller the privilege of delivering it on the day of purchase, or on any one of the three following days, without interest. Buyer 3 is a little lower, and seller 3 a little higher than "regular way" when the market is in a normal condition.

"Bucket-shops" are establishments conducted nominally for the transaction of a stock-exchange business, but really for the registration of bets or wagers, usually for small amounts, on the rise or fall of the prices of stocks, there being no transfer or delivery of the commodities nominally dealt in. There were formerly thousands of these counterfeit concerns throughout the country, conducted without any regard for legitimate commercial enterprises.

§ 381. **"Brokers."**—Brokers are persons employed as middlemen to transact business or negotiate bargains between merchants or individuals. There are

bill or exchange brokers who buy and sell foreign bills; note brokers who deal in promissory notes; stock brokers who buy and sell stocks for others. ship brokers who buy and sell cargoes in transit or upon arrival; insurance brokers who are middlemen between the insurance companies and the insured; custom house brokers who act for merchants in getting consignments through the custom house; and brokers in cattle, in dry goods, in coffee, in cotton, in drugs, in flour, in grain, in hides, in oil, in real estate, in sugar, in tobacco, in wool; in everything or anything that is bought or sold in large quantities.

By attending to one class of business constantly brokers acquire a more intimate knowledge of its various details, of the houses from which to buy, of the best market for sales, and of the credit of those engaged in it, than could possibly be expected of a general merchant.

The large manufacturers living outside of the great centers find it to their advantage to engage brokers to buy their raw material for them, so we find that each broker has his regular customers, and for a small commission he goes into the market and buys or sells as carefully as though he were spending his own money. It is for these reasons—from a sense of the advantages to be derived from using brokers in the transaction of business—that they are so extensively employed in New York, Chicago, London, and other great cities.

In France the brokers are called "agents de change." and their number in Paris is limited to sixty. They are severally obliged to give bonds

for the prevention of abuses, and are not allowed to charge more than a fixed rate of commission.

§ 382. **Stock Companies.**—To organize a stock company it is necessary for a number of persons to come together and make a certificate to the effect that they propose to form a company to bear a certain name, for the purpose of transacting a certain kind of business at a certain place. The certificate states that they propose to issue a certain number of shares of stock at a certain price per share, that the capital stock is to be a certain amount, and that the company is to continue to exist for a definite period of time. Blank forms for such certificates are supplied by the secretary of the state where the company is being organized and when properly filled out, signed, and delivered to him, he issues a license or charter to the persons making such certificate, giving them permission to open books, sell stock, and carry on the enterprise outlined. State laws regarding stock companies differ very largely.

§ 383. **Shares of Stock.**—The usual par value of a share of stock is $100. That is, if a company organize with a capital of $50,000, they will have 500 shares to sell. Each person who buys or subscribes for the stock, that is, who joins the company, receives a certificate of stock. These certificates are transferable at the pleasure of the owners. The transfer is made by a form of indorsement on the back of the certificate.

The men subscribing in this way become responsible for the good management of the business, and are

obliged to act according to the laws of the state in which the company is organized. Usually they are responsible individually for the liabilities if the concern should become bankrupt.

Every person who subscribes owns a part of the business and is called a shareholder. All the shareholders must meet together, and out of their number they choose a certain number of directors. The directors choose a president and other necessary officers and fix the amount of salary which shall be paid such officers for their work. As a rule directors have no salaries attached to their positions. A regular meeting of all the shareholders is held at least once a year to elect the directors and hear the reports of the officers. It is necessary to file a statement of resources and liabilities each year with the secretary of state. Corporations are now also required to file a statement of their affairs with the collectors of internal revenue.

The capital stock of a concern may be increased or diminished by a vote of the majority of the stockholders representing a majority of the stock.

§ 384. **Preferred Stock.**—The preferred stock of a corporation is given to secure some obligation of the company and upon it dividends are declared in preference to common stock. That is to say, if a man holds a share of preferred stock he will receive interest thereon out of the profits of the business before such profits are given in the form of dividends to shareholders generally.

§ 385. **Dividends.**—The directors of a company after paying the expenses and laying by a certain

amount for contingencies, divide the profits among the shareholders. These profits are called dividends, and in well managed companies the dividends which are declared quarterly, semi-annually, or annually usually amount to good interest on the shareholder's investment.

§ 386. **Surplus Fund.**—It is not customary to pay a larger dividend than good interest on the investment. In some states some classes of corporations are not permitted to declare dividends larger than a fixed amount. The profits remaining after expenses and dividends are paid are credited to what is called a surplus fund. This fund is the property of the shareholders and is usually invested in good securities.

§ 387. **Treasury Stock.**—It often occurs that a new company finds it necessary to set aside a certain number of shares to be sold from time to time to secure working capital. Such stock is held in the treasury until it is needed and is called treasury stock.

When a stock is issued, upon which a certain dividend is guaranteed it is called guaranteed stock.

§ 388. **Watered Stock.**—When stock is issued to the stockholders without increase of actual capital the stock is said to have been "watered." A company may organize for say $5,000 and may want to increase to $50,000 without adding to the number of its shareholders. Each holder of one share will in this instance receive nine new shares, and in future instead of receiving a dividend on one share he will receive a dividend on ten shares.

§ 389. **Limited Liability Companies.**—When the word Limited is affixed to a stock company's name, it signifies that each shareholder is individually liable to the creditors of the company for only the amount representing the value of the shares held by him or the stock for which he has subscribed. Understand clearly that the word Limited printed after the name of a company, and which is required there by law in some States does not indicate in any way that the capital or credit of the company is limited. It merely differentiates the liability of the stockholders from that of partners in a concern.

§ 390. **Sale of Stock.**—Stock is usually sold on certain explicit conditions, such as the paying of ten per cent down and the balance at stated intervals. If the conditions which are agreed to by the shareholders are not met his stock is declared forfeited, or he can be sued in the same manner as upon any other contract. Some companies organize with the understanding that a certain percentage of the nominal value of the shares is to be paid at the time of subscribing, and that future payments are to be made at such times and in such amounts as the company may require. Under these conditions the stockholders are assessed whenever money is needed to pay the company's expenses. Such assessments are uniform on all stockholders.

Questions for Review, Chapter XVII.

1. What is the economic value of the stock exchanges of the world?
2. Is there any reason why stocks and bonds should not be publicly dealt in?

3. What is the distinction made on the London Stock Exchange between "brokers" and "dealers"?

4. What are "room traders" on the New York Stock Exchange?

5. In what way are the stock exchanges supposed to guard the public interest?

6. What are the meanings of the terms "bull" and "bear"?

6. What are the meanings of the terms "bull' and "bear"?

7. What are "puts" and "calls"?

8. Describe the method of speculative trading on margins.

9. What is the distinction commonly drawn between a syndicate and a pool?

10. What is the advantage to a manufacturer of engaging brokers to buy their raw material for them?

11. What is necessary to organize a stock company?

12. How is the transfer of a certificate of stock made?

13. What is the nature of the preferred stock of a corporation?

14. What is meant by treasury stock?

15. What is the signification of the word "limited" affixed to a stock company's name?

16. What do you understand by the "curb" market?

CHAPTER XVIII

Monetary Events Since 1786.

1786.—Establishment of the double standard in the United States with a ratio of 1 to 15.25; that is, on the basis of 123.134 grains of fine gold for the half eagle, or $5 piece, and 375.64 grains of fine silver for the dollar, without any actual coinage.

1792.—Adoption of the ratio of 1 to 15 and establishment of a mint with free and gratuitous coinage in the United States; the silver dollar equal to 371¼ grains fine, the eagle to 247½ grains fine.

1803.—Establishment of the double standard in France on the basis of the ratio of 1 to 15½, notwithstanding the fact that the market ratio was then about 1 to 15.

1810.—Introduction of the silver standard in Russia on the basis of the ruble of 17.99 grams of fine silver, followed in 1871 by the coinage of imperials, or gold pieces of 5 rubles, of 5.998 grams; therefore, with a ratio of 1 to 15. This ratio was changed by the increase of the imperial to 5 rubles 15 copecks, and later to 1 to 15.45.

1815.—Great depreciation of paper money in England, reaching 26½ per cent in May. Course of gold,

£5 6s and of silver 71½d per ounce standard. In December the loss was only 6 per cent; gold at this period was quoted at £4 3s and of silver at 64d.

1816.—Abolition of the double standard in England, which had had as its basis the ratio of 1 to 15.21, and adoption of the gold standard on the basis of the pound sterling at 7.322 grams fine in weight.

Coinage of divisional money at the rate of 66d per ounce. Extreme prices, £4 2s for gold and 64d for silver in January, £3 18s 6d and 59¼d in December.

Substitution for the ratio of 1 to 15.5 in Holland, established by a rather confused coinage, of the ratio of 1 to 15⅞.

1819.—Abolition of forced currency in England. Price of gold, £3 17s 10½d and of silver 62d per ounce in October, against £4 1s 6d and 67d in February. (The price of silver given hereafter represents the average rate per ounce standard—that is, the mean between the highest price and the lowest price quoted during the year.)

1832.—Introduction of the monetary system of France in Belgium, with a decree providing for the coinage of pieces of 20 and 40 francs, which, however, were not stamped. Silver, 59¾d.

1834.—Substitution of the ratio of 1 to 16 for that of 1 to 15 in the United States by reducing the weight of the eagle, ten-dollar gold piece, from 270 grains to 258 grains.

In 1837 the fineness of the United States gold coins was raised from .899225 to .900, and the silver coins from .8924 to .900, giving a ration of 1 to 15.988, and

fixing the standard weight of the silver dollar at 412½ grains. Silver, 59 11-16d.

1835.—Introduction of the company rupee, a piece of silver weighing 165 grains fine, in India in place of the sicca rupee.—(Creation of a trade coin—the mohur, or piece of 15 rupees—containing 165 grains of fine gold. Silver. 59 11-16d.

1847.—Abolition of the double standard in Holland by the introduction of the silver standard on the basis of a 1-florin piece .945 grams fine, the coinage of which had already been decreed in 1839. Silver, 59 11-16d.

Discovery of the gold mines of California.

1848.—Coinage in Belgium of pieces of 10 and 25 francs in gold, a shade too light. These pieces were demonetized and withdrawn from circulation in 1884. Silver, 59½d.

Replacing the ratio of 1 to 16 in Spain, which had been in force since 1786, by that of 1 to 15.77.

1850.—Introduction of the French monetary system in Switzerland without any actual coinage of gold pieces. Silver, 60 1-16d.

1851.—Discovery of the gold mines in Australia.

1853.—Lowering of the weight of silver pieces of less value than $1 to the extent of 7 per cent in the United States and limitation of their legal-tender power to $5. Silver, 61½d.

Maximum of the production of gold reached in California when it amounted to $65,000,000.

1854.—Introduction of gold standard in Portugal

on the basis of the crown of 16.257 grams fine. Before this period the country had the silver standard, with a rather large circulation of gold coins stamped, on the basis of 1 to 15½ in 1835 and 1 to 16½ in 1847. Silver, 61½d.

Modification of the ratio of 1 to 15.77 in Spain by raising it to 1 to 15.48, and by lowering the piaster from 23.49 grams to 23.36 grams fine.

Introduction of the silver standard, as it existed in the mother country, in Java, in place of the ideal Javanese money, and coinage of colonial silver pieces.

1857.—Conclusion of a monetary treaty between Austria and the German States, in accordance with which 1 pound of fine silver (one-half a kilogram) was stamped into 30 thalers, or 52½ florins of south Germany, or 45 Austrian florins, resulting in 1 thaler equaling 1¾ German florins, or 1½ Austrian florins. Silver, 61¾d.

1861.—Law decreeing the coinage of gold pieces of 10 and 20 francs exactly equal to French coins of the same denomination in Belgium. Silver, 61¾d.

1862.—Adoption of the French monetary system by Italy. Silver, 61 7-16d.

1865.—Formation of the Latin Union between France, Belgium, Switzerland and Italy on the basis of a ratio of 1 to 15½. Silver, 61 1-16d.

1868.—Adoption of the French monetary system by Roumania, with the exclusion of the 5-franc silver piece, which was, however, stamped in 1881 and 1883. Silver, 60½d.

Admission of Greece into the Latin Union. The

definite and universal introduction of the French monetary system into the country was effected only in 1883.

Adoption of the French monetary system, with the peseta or franc as the unit, by Spain. The coinage of gold alphonses d'or of 25 pesetas was made only in 1876.

1871.—Replacing of the silver standard in Germany by the gold standard. Coinage in 1873 of gold pieces of 5, 10 and 20 mark pieces, the latter weighing 7.168 grams fine. Silver, 60½d.

Establishment of the double standard in Japan with the ratio of 1 to 16.17 by the coinage of the gold yen of 1.667 grams and of the silver yen of 26.956 grams, both with a fineness of .900.

1873.—Increase of the intrinsic value of the subsidiary coins of the United States. Replacing of the double standard by the gold standard. Reduction of the cost of coinage of gold to one-fifth per cent, the total abolition of which charge was decreed in 1875. Creation of a trade dollar of 420 grains, with a fineness of .900. Silver, 59¼d.

Suspension of the coinage of 5-franc pieces in Belgium.

Limitation of the coinage of 5-francs on individual account in France.

Suspension of the coinage of silver in Holland.

Formation of the Scandinavian Monetary Union. Replacing of the silver standard in Denmark, Sweden and Norway by that of gold on the basis of the krone.

Coinage of pieces of 10 and 20 kroner, the latter weighing 8.961 grams, with a fineness of .900.

1874—Introduction of the system of contingents for the coinage of 5-franc silver pieces in the Latin Union. Silver, 58 5-16d.

1875.—Suspension of the coinage of silver on individual account in Italy. Silver, 56⅞d.

Suspension of the coinage of silver on account of the Dutch colonies.

Introduction of the double standard in Holland on the basis of the ratio of 1 to 15.62 by the creation of a gold piece of 10 florins, weighing 5.048 grams fine, with the maintenance of the suspension of the coinage of silver.

1876.—Great fluctuations in the price of silver, which declined to 46¾d., representing the ratio of 1 to 20.172, in July. Recovery in December to 58½d. Average price, 52¾d.

1877.—Coinage of 5-franc silver pieces by Spain continued later, notwithstanding the decline of silver in the market. Silver, 54¾d.

Replacing of the double standard in Finland by that of gold on the basis of the mark or franc.

1878.—Act of United States Congress providing for the purchase, from time to time, of silver bullion, at the market price thereof, of not less than $2,000,000 worth per month as a minimum, nor more than $4,000,000 worth per month as a maximum, and its coinage as fast as purchased into silver dollars of 412½ grains. The coinage of silver on private account prohibited. Silver, 52 9-16d.

1879.—Suspension of the sales of silver by Germany. Silver, 51¼d.

1881.—Second international monetary conference in Paris. Silver, 51 11-16d.

1885.—Introduction of the double standard in Egypt. Silver, 48⅜d.

Prolongation of the Latin Union to January 1, 1891.

1886.—Great decline in the price of silver, which fell in August to 42d., representing a ratio of 1 to 22.5, and recovery in December to 46d. Modification of the coinage of gold and silver pieces in Russia. Silver, 45⅜d.

1887.—Retirement of the trade dollars by the government of the United States in February. Demonetization of the Spanish piasters, known as Ferdinand Carolus, whose reimbursement at the rate of 5 pesetas ended on March 11. New decline of silver in March to 44d., representing the ratio of 1 to 21.43. Silver, 44⅝d.

1890.—United States: repeal of the act of February 28, 1878, commonly known as the Bland-Allison law, and substitution of authority for purchase of 4,500,000 fine ounces of silver each month, to be paid for by issue of treasury notes payable in coin. (Act of July 14, 1890.) Demonetization of 25,000,000 lei in pieces of 5 lei in Roumania in consequence of the introduction of the gold standard by the law of October 27. Silver, 47 11-16d.

1891.—Introduction of the French monetary system in Tunis on the basis of the gold standard. Coin-

age of national gold coins and bullion. Silver 45 1-16d.

1892.—Replacing of the silver standard in Austria-Hungary by that of gold by the law of August 2. Coinage of pieces of 20 crowns, containing 6,098 grams fine. The crown equals one-half florin. Meeting of the third international monetary conference at Brussels. Production of gold reaches its maximum, varying between 675,000,000 and 734,000,000. francs. Silver, 39 13-16d.

1893.—Suspension of the coinage of silver in British India and of French trade dollars on individual account. Panic in the silver market in July in London, when the price fell to 30½d., representing the ratio of 1 to 30.92. Repeal of the purchasing clause of the act of July 14, 1890, by the Congress of the United States.

1895.—Adoption of the gold standard by Chile.

Russia decides to coin 100,000,000 gold rubles in 1896.

1896.—Cost Rica adopts the gold standard.

Russia decides to resume specie payments.

1897.—Adoption of the gold standard by Russia and Japan.

Peru suspends the coinage of silver and prohibits its importation.

1898.—Ecuador limited the tender of silver coins to the amount of 10 sucres.

1899.—India adopted the gold standard at the rate of 15 rupees to 1 pound sterling (British standard.)

1900.—United States adopted the gold standard.

Ecuador adopted the gold standard.

1901.—San Domingo adopted United States gold as standard.

1902.—Siam adopted the gold standard.

1903.—Colombia adopted gold standard.

Philippines adopted the gold standard.

1904.—Panama adopted gold standard.

1905.—Mexico adopted the gold standard.

1908.—Creation of a National Monetary Commission in the United States to report upon desirable changes in the monetary system.

1909.—December 21, special report to Congress by the Monetary Commission on the condition of the 25,000 banks in the United States.

1913.—Approval of Banking and Currency Act for the United States, establishing a system of Federal Reserve Banks, under the supervision of a Federal Reserve Board and designed to furnish a more elastic currency for commercial purposes.

1914.—Establishment of twelve Federal Reserve Banks, in principal banking centers of the United States, under the provisions of the Act of 1913.

1916.—Establishment by Act of Congress of Federal Farm Loan system, for encouragement of agriculture and development of rural credits.

1917.—United States enters the World War, with consequent bond issues.

1919.—General depreciation of European currency and fall in foreign exchange.

1920-22.—Period of general reconstruction following the war, with strenuous efforts on the part of all countries to effect a return to normalcy.

Questions for Review, Chapter XVIII.

1. In what year was the double standard established in the United States, and on what basis?
2. When was the United States Mint established?
3. In what year was the double standard abolished in England and the gold standard adopted?
4. What is meant by "the average rate for silver per ounce standard?"
5. When was the ratio of 1 to 16 substituted for that of 1 to 15 in the United States, and how was it accomplished?
6. In what years were the gold mines of California and Australia discovered?
7. When was the maximum of the production of gold reached in California and what was its value?
8. What was the basis of the Latin Union between France, Belgium, and Switzerland, and when was it formed?
9. When was the silver standard in Germany replaced by the gold standard?
10. What important monetary events occurred in the United States in 1873?
11. When was the Scandinavian Monetary Union formed and what was its basis?
12. What were the provisions of the United States Silver Coinage Act of 1878?
13. When did the first International Monetary Conference in Paris meet?
14. When was the Bland silver law in the United States repealed and what was substituted therefore?
15. What was the amount of the production of gold in 1892, when it reached its maximum?
16. When was the gold standard adopted in India? in the United States? in Mexico?
17. When was the National Monetary Commission appointed in the United States and for what purpose?

APPENDIX

1. History of Banking.
2. Provisions of the Edge Bill.

APPENDIX

HISTORY OF BANKING

There is but little information available as to the kind of banks that existed in the earlier ages, or on what system they conducted their business. As most of the nations of antiquity subsisted chiefly on agriculture, they probably had little occasion for banks; for it is only in commercial countries that these institutions have attained to any high degree of prosperity. And as even the commercial nations of antiquity were unacquainted with joint-stock companies or commercial corporations, and had not discovered the use of paper-money or bills of exchange, the business of a banker, even among them, must have been very different from that of a banker of the present day.

The merchants of those early times employed as money, gold and silver bullion; and received it and paid it away by weight. It is probable that the merchants would require that the precious metals they received should be of a certain degree of fineness. Thus when we read of a father in Israel weighing out as a payment 400 shekels of silver, "current money with the merchant"(Genesis xxiii, 16)—the phrase implies that the money current with the merchant was different from that in ordinary use.

After bullion was superseded by coin, and each nation had a coin of its own, the merchants would necessarily in the course of their business receive coins belonging to different nations, and hence would be applied to by strangers who wished to exchange their own money for the money of the country in which they sojourned. This would take place more particularly in those oriental countries whose inhabitants were accustomed in certain seasons to meet together for the celebration of public festivals.

The Jewish Money-Changers.—We read in the New Testament of money-changers who had tables in the temple of Jerusalem. It is probable they attended for the purpose of giving Jewish money in exchange for those various coins which persons coming from the neighboring countries might have brought with them.

Whether the business of money-changing was carried on as a separate employment, or united with the general business of a merchant, we are not informed; but it is stated that the exchangers allowed interest for money lodged in their hands. "Thou wicked and slothful servant, thou oughtest to have put my money to the exchangers, and then at my coming I should have received mine own with usury." (Matthew xxv, 27.) From the circumstances of their allowing interest on money, we may infer that they also lent money on interest; otherwise they would have had no use for the money they borrowed. This scanty information forms the whole of our knowledge respecting the mode of banking practised by the ancient Babylonian, Egyptian and Jewish nations.

The Banks of Ancient Greece.—With respect to the bankers of Greece we have more ample details, some of these being interestingly recounted by J. W. Gilbart, F. R. S., in his "History, Principles and Practice of Banking."

In Greece the first banks were the temples. We read that "the wealth and growing estimation of Delphi had also another source, of which information remains only so far as to assure us of the fact with far less explanation of circumstances than for its importance might be desired. In the general insecurity of property in the early ages, and especially in Greece, it was highly desirable to convert all that could be spared from immediate use into that which might more easily be removed from approaching danger. With this view, by a compact understood among men, the precious metals appear to have obtained their early estimation.

Gold and silver, having thus acquired their certain value as signs of wealth, a deposit secure against the dangers continually threatening, not individuals only, but every town and state in Greece, would be a great object of the wealthy. Such security was offered nowhere in equal amount as in the temples which belonged not to any single state, but were respected by the common religion of the nation. The priesthood, not likely to refuse the charge, would have a large interest in acquiring the reputation of fidelity to it. Thus the temple at Delphi appears to have become the great bank of Greece, perhaps before Homer, in whose time its riches seem to have been already proverbial. Such then was found

the value of this institution, that when the Dorian conquerors drove so large a part of the Greek nation into exile, the fugitives who acquired new settlements in Asia established there their own national bank in the manner of that of their former country, recommending it to the protection of the same divinity. The Temple of Apollo, at Branchidae, became the great depository of the wealth of Ionia. (Mitford's History of Greece.)

Afterward the temple of Olympia, like that of Delphi, became an advantageous repository for treasure. But although the temples discharged one of the offices of banks, by being places of security, yet as they did not grant interest on the money deposited, they did not supersede banks of deposit established by private individuals.

Methods of Athenian Bankers.—At Athens, especially, banking was a flourishing trade, which is thus described by the Abbe Barthelemy in "Travels of Anacharsis in Greece":

"The greater part of the Athenians employ their money in trade, but they are not permitted to lend it for any place but Athens. They receive an interest for the use of it which is not fixed by the laws, but stipulated in a contract, deposited either in the hands of a banker or some friend to both parties. If, for instance, a voyage is to be made to the Cymmerian Bosphorus, the instrument specifies the time of the departure of the vessel, the kind of commodities with which she is to be freighted, the sale which is to be made of them in the Bosphorus, and the merchandise which she is to bring back to Athens; and

as the duration of the voyage is uncertain, some agree that their money shall not be payable till the return of the vessel, while others, more timid, and contented with a less profit, require that it shall be repaid at the Bosphorus immediately after the sale of the goods carried out; in which case they either themselves repair to the place where they are to receive it, or send thither some person in whom they can confide, and whom they empower to act for them.

"The lender has his security, either on the merchandise or the goods of the borrower; but as the dangers of the sea are in part risked by the former, and the profit of the latter may be very considerable, the interest of money thus lent may rise as high as thirty per cent, more or less, according to the length and hazards of the voyage.

"The usury here spoken of is known by the name of maritime: that called landed usury is more oppressive, and no less variable.

"Those who, without risking the dangers of the sea, wish to derive profit from their money, lend it to bankers at the rate of twelve per cent per annum, or rather one per cent for every new moon. But as the laws of Solon do not prohibit those who have money from demanding the most extravagant interest for it, some persons receive more than sixteen per cent, and others, especially among the lower classes of people, exact every day the quarter of the principal. These extortions are not concealed and cannot be punished, except by the public opinion, which condemns, but does not sufficiently despise those who are guilty of them.

Commerce Gave Rise to Bankers.—"Commerce increases the circulation of wealth, and this circulation has given birth to the occupation of bankers, which facilitates it still more. A person who is about to make a voyage, or who fears to keep by him too great a sum of money, lodges it in the hands of these bankers, sometimes only as a trust, and without requiring any interest, and sometimes on condition of sharing with them the profits it shall produce. They advance money to generals who go to take on them the command of armies, or other individuals who stand in need of their assistance.

"In the greater part of bargains made by them, no witness is required; they content themselves with entering in a register that such a person has deposited in their hands such a sum, which they must repay to such another, if the former should happen to die. It would sometimes be very difficult to prove that they have received a sum of money, were they to deny it; but if they should expose themselves to such a charge more than once, they would lose the confidence of the public, on which depends their success in the business in which they are engaged.

"By employing the money deposited in their hands, and lending it at a greater interest than they are to pay for it, they amass riches which gain them friends, whose protection they purchase by assiduous services. But all is lost when, unable to call in their money, they are incapable of fulfilling their engagements. They are then obliged to conceal themselves, and can only escape the severity of justice by surrendering all their remaining property to their creditors.

"Those who wish to exchange foreign moneys apply to the bankers, who by different means, as the touchstone and the balance, examine whether they are not adulterated or deficient in weight."

The First Joint-Stock Bank.—In a treatise published by Xenophon, upon the Athenian revenue, we meet with the first suggestion for the establishment of a joint-stock bank. Of this historic step, Mitford says: "A very remarkable project, which seems to have been original with Xenophon, next occurs—the establishment of a bank by subscription, open to all the Athenian people. The interest of money, it appears, was enormous at Athens, an unavoidable consequence of the wretched insecurity of person and property. Throughout modern Europe, land is, of all property, esteemed the safest source of income; but in Greece it was held that the surest return was from money lent at interest. For in the multiplied division of Greece into small republics with very narrow territories, the produce of land was continually liable to be carried off or destroyed by an invading enemy, but a moneyed fortune, according to Xenophon's observation, was safe within the city walls. In proportion, then, to the interest of money, and the insecurity of all things, the profits of trade will always be high, and thus numbers would be induced to borrow, even at a high interest.

"Xenophon therefore proposed, by lending from the public stock, and encouraging commercial adventure by just regulations, to raise a great revenue, and, by the same means, instead of oppressing to enrich individuals. As corollary then, to his project,

when the amount of the subscription or its profits might allow, he proposed to improve the ports of Athens, to form wharves and docks, to erect halls, exchanges, warehouses, market-houses, and inns, for all which tolls and rents should be paid; and to build ships to be let to merchants. Thus, while numbers of individuals were encouraged and enabled to employ themselves for their private benefits, the whole Athenian people would become one great banking company, from whose profits every member, it was expected, would derive at least an easy livelihood."

The Banks of Ancient Rome.—In Rome, the bankers were called Argentarii, Mensarii, Numularii, or Collybistae. The banking-houses or banks were called Tabernae Argentariae, or Mensae Numulariae. Some of these bankers were appointed by the government to receive the taxes, others carried on business on their own account. Their mode of transacting business was somewhat similar to that which is in use in modern times.

Into these houses the State, or men of wealth, caused their revenues to be paid, and they settled their accounts with their creditors by giving a draft or check on the bank. If the creditor also had an account at the same bank, the account was settled by an order to make the transfer of so much money from one name to another. To assign over money or to pay money by a draft, was called "praescribere," and "rescribere"; the assignment or draft was called "attributio."

Roman Bankers in Disrepute.—These bankers, too, were money-changers. They also lent money

on interest, and allowed a lower rate of interest on money deposited in their hands.

In a country where commerce was looked upon with contempt, banking could not be deemed very respectable. Among most of the ancient agricultural nations there was a prejudice against the taking of interest for the loan of money. Hence the private bankers at Rome were sometimes held in disrepute, though, on the other hand, those whom the government had established as public cashiers, or receivers-general, as we may term them, held so exalted a rank that some of them became consuls.

The Romans had also loan banks, from which the poor citizens received loans without paying interest. We are told that the confiscated property of criminals was converted into a fund by Augustus Caesar, and that from this fund sums of money were lent without interest to those citizens who could pledge value to double the amount. The same system was pursued by Tiberius. He advanced a large capital, which was lent for a term of two or three years to those who could give landed security to double the value of the loan. Alexander Severus reduced the market-rate of interest by lending sums of money at a low rate, and by advancing money to poor citizens to purchase lands, and agreeing to receive payment from the produce.

Origin of the Word "Bank."—After commerce and the arts had revived in Italy, the business of banking was resumed. The word "bank" is commonly regarded as derived from the Italian word "banco," a bench—the Jews in Lombardy having

benches in the market-place for the exchange of money and bills. When a banker failed, his bench was broken by the populace; and from this circumstance we have our word "bankrupt."

But while this is the derivation generally accepted, some writers have asserted that a more accurate explanation of the use of the word "bank" is that which makes it synonymous with the Italian "monte" (Latin "mons, montis)", a mound, heap, or bank. Thus the Italian Monte di Pieta and the French Monte de Piete signify "a Charity Bank." Bacon and Evelyn use the word in the same sense.

Bacon says: "Let it be no bank or common stock, but every man be master of his own money." Evelyn, referring to the Monte di Pieta at Padua, writes: "There is a continual bank of money to assist the poor." Blackstone also says: "At Florence, in 1344, government owed £60,000, and being unable to pay it, formed the principal into an aggregate sum called, metaphorically a Mount or Bank."

The Florentine Bankers.—Though the states of Venice and Genoa made the most rapid advances in commerce, and established public banks, yet the department of banking appears to have fallen more particularly into the hands of the Florentines.

"As the Florentines did not (like the Venetians and the Genoese) possess any commodious seaport, their active exertions were directed chiefly towards the improvement of their manufactures and domestic industry. About the beginning of the fourteenth century, the Florentine manufacturers of

various kinds, particularly those of silk and woolen cloth, appear, from the enumeration of a well-informed historian, to have been very considerable. The connections which they formed in different parts of Europe, by furnishing them with the productions of their own industry, led them to engage in another branch of trade, that of banking. In this they soon became so eminent, that the money transactions of almost every kingdom in Europe passed through their hands, and in many of them they were entrusted with the collection and administration of the public revenues. In consequence of the activity and success with which they conducted their manufactures and money transactions—the former always attended with certain though moderate profit, the latter lucrative in a high degree, at a period when neither the interest of money nor the premium on bills of exchange was settled with accuracy—Florence became one of the first cities in Christendom, and some of its citizens extremely opulent." (Robertson's "Disquisition on India.")

Cosmo di Medici of Florence was reckoned in his day the most wealthy merchant ever known in Europe, and in a treaty whereby Louis XI engaged to pay Edward VI fifty thousand crowns annually, it was expressly stipulated that the king of France should engage the partners of the Bank of Medici to become bound for the faithful and regular performance of this agreement on the part of himself and his heirs.

The Earliest National Banks.—Although the business of banking has probably always been carried

on by private individuals before it has been carried on by a public company, yet most countries have found it useful to establish a public or national bank. Some of these banks have been founded for the purpose of facilitating commerce, others to serve the government. The most ancient of these was founded at Venice.

The Bank of Venice.—The first establishment of banking, in a regular and systematic form, took place at Venice about the middle of the twelfth century (1157); and it arose from the necessities of the state. Duke Vitale, Mitchell II, being involved in expensive wars with the Empire of the West, and the Grecian Manuel, embarrassed the finances of the republic; and to relieve it from the pressure of its difficulties, he had recourse to a forced loan, the contributors to which were made creditors, and received interest at the rate of four per cent per annum. The "Chamber of Loans" was established for the management of this fund, and regular payment of the interest; which, gradually improving its plan, at last formed itself into the more perfect institution of the Bank of Venice.

This celebrated bank served as a model to almost every similar establishment in succeeding ages; its capital was 5,000,000 ducats, or $4,800,000, for which the republic was security. It was, properly, a board of deposit, credit and interest. By an edict of the state, all payments of wholesale merchandise, and bills of exchange, were required to be made in banco, or bank notes; and all debtors were obliged to lodge their money in the bank, that their creditors might receive payment in banco; which was done by

transferring the amount from the one to that of the other, or by writing off the sum from the account of the debtor, and placing it to that of the creditor. Payments were made in this manner without the intervention of gold or silver; but there were exceptions to this rule in cases of retail trade, or when foreigners wished to carry off the precious metals.

All the riches of the state thus flowed into the bank; and, through various channels, were again diffused among traders, to give activity to the extensive commerce of this once opulent and powerful city.

From its good faith, and the regularity of its transactions, the Bank of Venice always maintained a high character in Europe, and on some occasions, its obligations were more esteemed than the bonds of kings. This bank may well be deemed a wonder for the twelfth century, but required much alteration in methods to adapt it to the requirements of the nineteenth and twentieth centuries.

During two centuries and a half the Bank of Venice was unrivaled. The progress of human knowledge was slow and improvements in banking methods were long in coming.

The Bank of Barcelona.—As early as the year 1349 the business of banking was carried on after a fashion by the drapers of Barcelona, who were probably the most wealthy class of merchants in that city. But by an ordinance of the king of Arragon, they were not allowed to commence this branch of trade until they had first given sufficient security. In the year 1401 a public bank was established by

the magistrates. It was called the Table of Exchange, and was properly a bank of exchange and deposit. Foreign bills were negotiated with the same liberality as those of the citizens, and accommodations were extended to strangers as well as to natives. It was altogether calculated for the encouragement of both external and internal commerce, and the funds of the city were pledged as security for the responsibility of the bank.

The Bank of Genoa.—In the year 1407, the bank of Genoa commenced, owing its origin to the debts of the state. Previous to this time, the republic borrowed large sums of money from the citizens, assigning certain branches of the revenue for the payment of the interest, and accounting to government for the funds entrusted to its care. From this circumstance, the Genoese claim the merit of establishing a bank as early as the Venetians; but it is evident that the transactions of this board were only an approximation to banking. In process of time, however, the multiplicity and extent of these funds induced disorder and confusion, and it was deemed expedient to consolidate the whole into one capital stock, to be managed by a bank called the Chamber of St. George, to be governed by eight protectors, annually chosen, elected by the creditors and stockholders. Under this form of government, the affairs of the bank were prosperously conducted; but the further increase of the public debts, and the acquirement of towns and territories as security, among which were the port of Caffa and the little kingdom of Corsica, made the business of the bank much more complex; and the inconvenience of an-

nual successions of new protectors becoming apparent, determined the Genoese, in the year 1444, to elect eight new governors for the management of the bank, of which only two were to go out every year.

First Bills of Exchange.—Before the discovery of the passage to the Indias, by the Cape of Good Hope, the Venetians enjoyed a monopoly of the lucrative trade of the east, by means of the Mamelukes of Egypt, with whom they were leagued by policy and interest, which diffused opulence and wealth throughout Italy. This extensive commerce created and gave circulation to bills of exchange, the credit and currency of which were universally acknowledged when they bore the signature of the banks of Italy, and for several centuries there were no other establishments of the kind in Europe.

The Bank of Amsterdam.—The Bank of Amsterdam was established on the 31st of January, 1609. The magistrates of the city, under authority of the States, declared themselves the perpetual cashiers of the inhabitants, and that all payments above 600 gilders (afterwards reduced to 300) and bills of exchange, should be made in the bank; which obliged merchants to open accounts with it for the payment of their foreign bills. The extensive commerce of Amsterdam involved such a variety of transactions that the expediency of regulating them became evident, and no measure could more effectually secure property, check lawsuits, and prevent frauds, than the establishment of a bank office, in which all receipts and payments were registered in books kept open for the purpose.

The origin of this bank is ascribed to the debased state of the current coin which the trade of Amsterdam brought from all quarters of Europe, and which was sold at a reduction of nine per cent below the money of the mint. Merchants, in such cases, could not always find standard money to pay bills of exchange, the value of which was always uncertain; and accordingly operated against the United Provinces with foreign nations. But as the bank received the debased, light, or worn coin, at its intrinsic value in the good money of the country, and gave credit for the amount in its books, an invariable standard was thus established, that tended greatly to simplify and facilitate the operations of commerce.

Bank Money at a Premium.—The beneficial effects of this establishment in Holland were soon perceived, and bank money immediately bore a premium called the "agio," which is a term to denote the difference of price between the money of the bank and the coin of the country.

When we consider that coin is only a representative of commodities, and that its utility arises only from its being a generally acknowledged measure and standard of value, by which mankind in the civilized state of society are enabled to calculate the price of articles of exchange, it was not surprising that bank receipts, which represent property also, and at the same time are not liable to risk, danger, or deterioration of any kind, should be held in higher estimation than coin, which is exposed to robbery, and all sorts of casualities.

In all countries where banks have been regular in their transactions and their responsibility undoubted, their paper has carried a premium, more or less, according to circumstances, and the agio of Amsterdam was generally about five per cent.

The Bank Capital.—The amount of capital of the Bank of Amsterdam was never exactly ascertained. It was generally constituted by depositors of coin, and there was full value in its coffers for all the credits and receipts it issued. The bank, however, gave credit and receipts also upon deposits of gold and silver bullion, at the rate of five per cent less than the mint price of such bullion, which was restored to the owner if he called for it within six months, upon paying one-fourth per cent if the deposit was in silver, or one-half per cent if in gold. But if the term of six months was allowed to expire, the bank retained the bullion at the price stated in its books.

The advantage of making deposits in this bank was two-fold: First, the credit enabled the merchant to pay his bills of exchange; second, the receipt gave him an opportunity of selling his bullion at an advance price, if the market should fluctuate in his favor. "Although none could draw out bullion without producing a receipt, and reassigning bank money equal to the price at which the bullion had been received, yet it was not absolutely necessary that both credit and receipt should always remain in the hands of the same person; as he who had the receipt could find bank money to buy at the market price, to enable him to relieve the bullion, and the owner of the

credit could at all times find receipts in abundance; but to prevent any extraordinary rise in the price of bank money, or receipts, which speculation or other causes might sometimes induce, the bank adopted the resolution of selling bank money for the current coin, at an agio of five per cent, and buying it at the rate of four.

"The city of Amsterdam was guaranty that there should always be full value in the bank to answer all its demands; and as the directors, who were annually changed, compared the treasure with the books, under solemn oath, there could be no probability of fraud."

Managed by the Burgomasters.—The four reigning burgomasters were invested with the direction of the bank, and the city of Amsterdam derived a considerable revenue from it, which arose from the following sources: "For all deposits, a fourth or half per cent had to be paid; from every person who opened an account, a fee of ten gilders was exacted, and for every additional account, three gilders three stivers; for every transfer, two stivers, or six stivers if the transfer was less than three hundred gilders. If any person overdrew his account, he was fined three per cent on the amount, and his order was set aside. There was also a considerable profit on the sale of foreign coin, or bullion, which was always kept till it could be sold to advantage; and likewise by selling bank money, at five per cent agio, and buying it at four.

Through these various resources, the Bank of Amsterdam became rich and prosperous, and it was

supposed to retain in its repositories more gold and silver than any other establishment of the kind in Europe.

The Bank of Amsterdam was the model on which were formed many of the older European banks, but they have varied very considerably from each other, according to the circumstances of the respective countries in which they have been established.

The Bank of North America.—The Bank of North America owed its origin to the vigorous mind and enterprising genius of Robert Morris, who conceived the idea of it when superintendent of the public finances, and submitted to Congress in the month of May, in the year 1781, the plan for establishing a national Bank of North America.

Agreeably to this plan, the capital was to consist of 1,000 shares, of $400 each, or $400,000, payable in gold and silver, to be increased by new subscriptions, from time to time, at the pleasure of the directors. The directors, twelve in number, were to be chosen by the stockholders, and were to be intrusted with the management of the institution. The notes of the bank payable on demand were to be made a legal tender in the discharge of duties, taxes, etc.

On the 26th of May, in the same year, Congress approved of the plan, and passed several resolutions, by which it pledged itself to support the proposed institution; to incorporate the subscribers, under the name of the president, directors, and company of the Bank of North America; to recommend to the several states the prevention of similar establishments within their respective jurisdictions, during

the war; to receive the notes of the institution in payment of taxes, duties, and debts due to the United States, and to use its influence with the several legislatures, to have laws passed, which should make it a felony to counterfeit the notes of the bank, etc.

After this, subscriptions were immediately opened during the summer and autumn of the same year. In November, directors were chosen. In December, Congress, conformably to its former resolutions. passed an ordinance which created the subscribers to the bank a corporation for ever, under the title of "The President, Directors, and Company of the Bank of North America." The original features of the plan were preserved, but the bank was restricted from holding property exceeding the amount of $10,000,000.

The institution commenced its operations in the month of January following, and Robert Morris, who may be justly styled the father of the system of credit, and paper circulation in the United States succeeded in securing for it the good-will and confidence of the people at large, by various judicious measures, of which a circular letter, addressed to the governors of the several states, explaining the object of the institution, and the certain advantages to be derived from it, was not the least effectual.

"Thus the first bank in the United States came into existence, and such was its happy and immediate influence on the public finances, and on commercial concerns in general," says Goddard in his History of Banking Institutions, "that it may be justly doubted

whether, without its seasonable aid, the revolutionary struggle for independence could have been brought to a satisfactory termination.

An Aid to the Government.—"The United States, for several years, was constantly indebted to the bank, to a larger sum than the stock they owned; nor could the various devices for creating a revenue have answered their end, or the army have been fed and clothed, or any degree of order and punctuality maintained in the dispatch of public affairs but for the great facility in the management of business, and the restoration of confidence, which were created by this institution. The sense of the great utility of the bank, was so universal, that Massachusetts and Pennsylvania corroborated the ordinance of Congress, by additional charters, and Rhode Island, Connecticut, and Delaware passed laws for the purpose of preventing the counterfeiting of its notes.

"Yet when peace had been concluded, and the pressure of the times was over, there were not wanting those who viewed the prosperous state of the affairs of the bank with a jealous eye, and conjured up imaginary fears of an overbearing oppression, an alarming foreign influence, and fictitious credit, from temporary punctuality; of a created scarcity of specie; possible commercial convulsions, from the stopping of discounts; partial favors, and comparative disadvantages, under which distant traders labored; as if, in a moral community, the bare possibility of abuse could ever furnish a good argument against the decided utility of a thing; or as if a benefit were to be relinquished, because all cannot be

benefited alike. And so effectually were those objections against the institution urged, that on the 13th of September, 1785, the legislature of Pennsylvania actually repealed its charter."

The repeal was persevered in by the succeeding legislature, notwithstanding innumerable petitions to the contrary, and vast efforts to enlighten their proceedings.

The bank, however, continued its usual operations under the charter from Congress, and in the enjoyment of corporate rights, which, it was presumed, could not be arbitrarily wrested from them after having been once legally bestowed.

The legislature which met in December, 1786, at last thought proper to renew the charter of the bank, and passed an act to that effect, on the 7th of March, 1787, by which, however, the term of the charter was limited to fourteen years, and the capacity of the corporate body of holding property was restricted to two millions of dollars. The same charter was extended for the term of fourteen years more, by an act passed on the 20th of March, 1799.

Bank of the United States.—The first Bank of the United States was chartered by Congress on February 25, 1791, for twenty years. The authorized capital was $10,000,000, of which the Government took $2,000,000. The notes issued by the bank were receivable by the Government for all debts due to it. The charter of this bank did not prevent the rise of a considerable number of banks in the various States, which also issued notes. But by reason of its larger capital, and its several branches in different parts of

the country, the Bank of the United States dominated the entire banking system and regulated the issue of the State Banks.

Early in the nineteenth century the Government sold its stock in the bank, and when the charter expired in 1811 the Government had no direct interest in its renewal. The renewal of the charter was opposed by the State banks, and when the effort to secure it failed, the bank wound up its affairs.

Congress chartered the second Bank of the United State on April 3, 1816, at Philadelphia, with power to establish branches. This bank continued operations until 1837, when it failed in the general crisis, the government deposits having been withdrawn some time previously.

Growth of State Banks.—The refusal to continue the National Bank was followed by an immense growth of the State banking institutions. In 1837 there were 788 of them, with a capital of $291,000,000. The necessity for suspension of specie payments in 1837 and again in 1857 taught valuable lessons to the bankers of the country, and the movement for a national banking law took form in 1863, during the Civil War, with the passage of an act requiring the issue of bank notes to be based upon the deposit of government bonds with the Treasury. In 1864 a bureau in the Treasury Department, presided over by the Comptroller of the Currency, was given supervision over the national banking system, and definite rules for the establishment of banks were prescribed. The banks were required to maintain sufficient reserves, and by October 1866, the

number of national banks had reached 1,644. By 1913 this number had grown to 7,473, with capital, surplus, and undivided profits amounting to $2,045,000,000, and deposits of nearly six billion dollars.

In 1910 a Monetary Commission was appointed by the United States Senate to investigate the whole question of banking reform, and the upshot was the establishment of the Federal Reserve Bank system by an act passed December 23, 1913. The features of this system are described at length elsewhere in this volume.

Early Banking in England.—We may now trace the rise and development of banking in England, as a leading and typical commercial nation, this being an integral part of the history of banking prior to its development in the United States.

For several centuries the only coin current in England was made of silver, and the highest denomination was the silver penny. This coin contained about half as much silver as one of the modern sixpences. There were also silver half-pence and silver farthings, and frequently the silver pennies were cut into halves and quarters to serve the purpose of half-pence and farthings, until laws were made to prohibit the practice. Copper was not coined in England until the year 1609, and then the small leaden token previously issued by private individuals was suppressed.

Gold was first coined in England in 1257, but soon went out of circulation, and did not enter permanently into currency until 1344 when Edward III issued gold nobles, half nobles, and farthing nobles; the

noble to pass for 6s. 8d., the half noble for 3s. 4d., and the farthing noble for 1s. 8d.

Office of Royal Exchanger.—This coinage seems to have given rise to the office of Royal Exchanger. We find the following in Henry's history of England: "It was not so easy a matter in the times we are now considering to exchange gold and silver coins for each other as it is at present, and therefore Edward III and several of his successors took this office into their own hands, to prevent private extortion as well as for their own advantage, and they performed it by appointing certain persons furnished with a competent quantity of gold and silver coins, in London and other towns, to be the only exchangers of money, at the following rate: When these royal exchangers gave silver coins for a parcel of gold nobles, for example, they gave one silver penny less for each noble than its current value, and when they gave gold nobles, for example, they gave one silver penny less for each noble than its current value, and when they gave gold nobles for silver coins they took one penny more, or 6s. 9d. for each noble, by which in every transaction, they made a profit of 1 1-5 per cent.

These royal exchangers had also the exclusive privilege of giving the current coins of the kingdom in exchange for foreign coins, to accommodate merchant-strangers, and of purchasing light money for the use of the mint. As several laws were made against exporting English coin, the king's exchangers at the several seaports furnished merchants and others who were going beyond seas with the coins of the countries to which they were going,

in exchange for English money, according to a table which hung up in their office for public inspection. By these various operations they made considerable profits, of which the king had a certain share. The house in which the royal exchanger of any town kept his office was called the Exchange, from which it is probable the public structures where merchants meet for transacting business derive their name."

Re-established by Charles I.—This institution continued until the middle of the reign of Henry VIII, when it fell into disuse. It was re-established in 1627, by Charles I, who then issued the following proclamation:—

"Whereas the exchange of all manner of gold and silver current in moneys or otherwise, as the buying, selling and exchanging of all manner of bullion, in species of foreign coins, billets, ingots, etc., fine refined, or alloyed howsoever, being fit for our mint, hath ever been and ought to be our sole right, as part of our prerogative royal and ancient revenue, wherein none of our subjects of whatever trade or quality soever, ought at all, without any special license, to intermeddle, the same being prohibited by divers Acts of Parliament and Proclamations, both ancient and modern.

"And whereas ourself and divers of our royal predecessors have, for some time past, tolerated a promiscuous kind of liberty to all, but especially to some of the mystery and trade of goldsmiths in London and elsewhere, not only to make the said exchanges, but to buy and sell all manner of bullion, and from thence some of them have grown to that

licentiousness, that they have for divers years presumed, for their private gain, to sort and weigh all sorts of money current within our realm, to the end to cull out the old and new moneys, which, either by not wearing or by any other accident, are weightier than the rest, which weightiest moneys have not only been molten down for the making of plates, etc., but even traded in and sold to merchant-strangers, etc., who have exported the same, whereby the consumption of coins has been greatly occasioned, as also the raising of the silver even of our own moneys to a rate above what they are truly current for, by reason whereof no silver can be brought up to our mint but to the loss of the bringers, etc.

"For the reforming of all which abuses we have, by the advice of our Privy Council, determined to assume our said right, for our own profit and the good of the realm, and for this end we do now appoint Henry, Earl of Holland, and his deputies, to have the office of our changes, exchangers, and outchanges whatsoever, in England, Wales, and Ireland. And we do hereby strictly charge and command that no goldsmith nor other person whatsoever, other than the said Earl of Holland, do presume to change, etc.

The King's Prerogative.—As this measure occasioned some dissatisfaction, the king authorized, in the following year, the publication of a pamphlet, entitled "Cambium Regis, or the Office of his Majesty's Exchanger Royal." In this pamphlet it was attempted to be shown:—

"That the prerogative of exchange of bullion for

coin has always been a flower of the Crown, of which instances are quoted from the time of King Henry I downward. That King John farmed out that office for no smaller a sum than five thousand marks—that the place or office where the exchange was made in his reign was near St. Paul's Cathedral in London, and gave name to the street still called the Old 'Change—that in succeeding reigns there were several other places for those exchangers besides London —that this method continued to Henry the Eighth's times, who suffered his coin to be so far debased that no regular exchange could be made—that the same confusion made way for the London goldsmiths to leave off their proper trade of goldsmithrie, i, e., the working and selling of new gold and silver plate, and manufacture, the sole intents of all their charters, and to turn exchangers of plate and foreign coins for our English coins, although they had no right to buy any gold or silver for any other purpose than for their manufacture aforesaid, neither had any person but those substituted by the Crown a right to buy the same.

"The king, therefore, has now resumed this office, not merely to keep up his right so to do, but likewise to prevent those trafficking goldsmiths from culling and sorting all the heavy coin, and selling the same to the mint of Holland, which gained greatly thereby, or else by melting those heavy coins down for making of plate, witness the pieces of thirteenpence-halfpenny, old shillings of Queen Elizabeth, ninepenny and fourpenny-halfpenny pieces, which, being weighty moneys, none of them were now to be met with, whereby they have raised the price of silver

to two-pence per ounce above the value of the mint, which thereby has stood still ever since the eleventh year of King James—that for above thirty years past it has been the usual practice of those exchanging goldsmiths to make their servants run every morning from shop to shop to buy up all weighty coins for the mints of Holland and the East countries, whereby the king's mint has stood still."

Not only the Goldsmiths' Company of London, but the lord mayor, court of aldermen, and common council, petitioned against the revival of the office of the Royal Exchanger, says J. W. Gilbart in his History of Banking. They were not, however, successful; and on a second application of the Goldsmiths' Company, the king told them "to trouble him no farther, since his right to the office was undoubtedly clear." After the death of Charles I. however, this office was not continued, and the business of money-changing fell again into the hands of the goldsmiths.

Money-Lending.—That part of the business of banking which consists in the lending of money was conducted during the Middle Ages under severe restraints. The taking of interest for the loan of money was deemed sinful, and stigmatized with the name of usury. This opinion appears to be wholly unwarranted, either by the principles of natural equity or the enactments of the Mosaic law.

Michaelis says in his Commentaries on the Laws of Moses: "That taking of interest from Israelites was forbidden by Moses; not, however, as if he absolutely and in all cases condemned the practice, for he expressly permitted interest to be taken from

strangers, but out of favor to the poorer classes of the people. The farther we go back towards the origin of nations, the poorer do we commonly find them, and the more strangers to commerce; and where this is the case, people borrow, not with a view to profit, but from poverty, and in order to procure the necessaries of life; and there it must be, no doubt, a great hardship to give back more than has been gotten. The taking of interest from strangers, Moses has not only nowhere forbidden, but even expressly authorized. Hence it is clear that he does by no means represent interest as in itself sinful and unjust. Any such prohibition of interest in our age and country would, without doubt, be unjust towards lenders, and destructive to trade of every description. Among all the remnants of ancient laws, it would be difficult to find one which, in the present state of society, it would be more foolish and hurtful to revive and enforce. It would only suit a state so constituted as was that of the Israelites by Moses."

Early Rates of Interest.—The taking of interest for the loan of money was first prohibited in England by Edward the Confessor. This law, however, appears to have become obsolete; for, in a council held at Westminster, in the year 1126, usury was prohibited only to the clergy, who, in case they practiced it, were to be degraded; and in another Council, held twelve years afterwards, it was decreed that, "such of the clergy as were usurers and hunters after sordid gain, and for the public employments of the laity, ought to be degraded."

The earliest mention in English history of a certain yearly allowance for the usury or interest of

money, is in the year 1199, the tenth and last year of Richard I. In this case the rate of interest was 10 per cent. This appears to have been the ordinary or market-rate of interest from that period until the time of Henry VIII, but there are many instances on record of a much higher rate of interest being taken, especially by the Jews and the Lombards, who, in those times, were the principal money-lenders. The exorbitant interest taken by them is supposed by eminent writers to have been the effect of the prohibition of usury.

The Jews, who were previously famous in foreign countries for their "egregious cunning in trade and in the practice of brokerage," arrived in England about the time of the Norman Conquest (1066) and soon became remarkable for wealth and usury. "The prejudices of the age," says Hume, "had made the lending of money on interest pass by the invidious name of usury; yet the necessity of the practice had still continued it, and the greater part of that kind of dealing fell everywhere into the hands of the Jews. The industry and frugality of this people had put them in possession of all the ready money, which the idleness and profusion common to the English with the European nations enabled them to lend at exorbitant and unequal interest."

Henry III prohibited the Jews taking more than twopence a week for every 20 shillings they lent to the scholars at Oxford. This is at the rate of £43 6s. 8d. per cent per annum. Peter of Blois, Archdeacon of Bath, wrote thus to his friend the Bishop of Ely: "I am dragged to Canterbury to be crucified by the

perfidious Jews amongst their other debtors, whom they ruin and torment with usury. The same sufferings await me also at London, if you do not mercifully interpose for my deliverance. I beseech you, therefore, O most Rev. Father and most loving friend, to become bound to Samson the Jew for £6 which I owe him, and thereby deliver me from that cross."

Expulsion of the Jews.—The wealth and the rapacity of the Jews occasioned the most cruel proceedings against them on the part of both the populace and the Government. These persecutions terminated by their expulsion from England in the year 1290. They were not admitted until the time of Oliver Cromwell.

On this occasion the Protector summoned an assembly to debate two questions: First, whether it were lawful to tolerate the Jews; Second, if it were, on what conditions? The assembly consisted of two judges, seven citizens of London, among whom were the lord mayor and the sheriffs, and fourteen divines. The judges considered toleration merely as a point of law, and declared they knew of no law against it, and that if it were thought useful to the State, they would advise it. The citizens viewed it in a commercial light, and they were divided in their opinion about its utility. Both these, however, despatched the matter briefly; but the divines violently opposed it by text after text for four whole days. Cromwell was at length so weary that he told them he had hoped they would have thrown some light on the

subject to direct his conscience but, on the contrary, they had rendered it more obscure and doubtful than before; that he desired, therefore, no more of their reasonings, but lest he should do anything rashly, he begged a share in their prayers.

The Lombards as Usurers.—Previous to the expulsion of the Jews, the Lombards had settled in England, and they soon became as great usurers as the Jews themselves. By Lombards were generally understood Italian merchants from the four republics of Genoa, Lucca, Florence, and Venice.

The foreign commerce of those times was usually carried on by companies of merchants who, on payment of certain duties, were invested by the Government with a monopoly of the trade to those countries of which they were natives, and they also possessed peculiar privileges.

"As the Lombards engrossed the trade of every kingdom in which they settled, they soon became masters of its cash. Money, of course, was in their hands not only a sign of the value of their commodities, but became an object of commerce itself. They dealt largely as bankers. In an ordinance, A. D. 1295, we find them styled 'mercatores' and 'campsores.' They carried on this, as well as other branches of their commerce, with somewhat of that rapacious spirit which is natural to monopolizers who are not restrained by the competition of rivals. An opinion which prevailed in the Middle Ages was, however, in some measure the cause of their exorbitant demands, and may be pleaded in apology for them.

"Commerce cannot be carried on with advantage, unless the persons who lend a sum are allowed a certain premium for the use of their money, as a compensation for the risk which they run in permitting another to traffic with their stock. This premium is fixed by law in all commercial countries, and is called the legal interest of money. But the Fathers of the Church absurdly applied the prohibitions of usury in Scripture to the payment of legal interest, and condemned it as a sin. The schoolmen, misled by Aristotle, whose sentiments they followed, implicitly and without examination adopted the same error and enforced it. Thus the Lombards found themselves engaged in a traffic which was deemed criminal and odious. They were liable to punishment if detected. They were not satisfied, therefore, with that moderate premium which they might have claimed, if their trade had been open and authorized by law. They exacted a sum proportional to the danger and infamy of a discovery. Accordingly we find it was usual for them to demand twenty per cent for the use of money in the thirteenth century.

"About the beginning of that century the Countess of Flanders was obliged to borrow money in order to pay her husband's ransom. She procured the sum requisite, either from Italian merchants or from Jews. The lowest interest which she paid to them was above twenty per cent, and some of them exacted near thirty. In the fourteenth century, A. D. 1311, Phillip IV fixed the interest which might be legally exacted in the fairs of Champagne at twenty per cent. The interest of money in Arragon was somewhat lower. James I in A. D. 1242, fixed

it by law at eighteen per cent. As late as the year 1490, it appears that the interest of money in Piacenza was at the rate of forty per cent. This is the more extraordinary, because at that time the commerce of the Italian States was become considerable.

"It appears from Lud. Guicciardini that Charles V had fixed the rate of interest in his dominions in the Low Countries at twelve per cent, and at the time when he wrote, about the year 1560, it was not uncommon to exact more than that sum. He complains of this as exorbitant, and points out its bad effects both on agriculture and commerce. This high interest on money is alone a proof that the profits on commerce were exorbitant. The Lombards were also established in England in the thirteenth century, and a considerable street in the city of London still bears their name. They enjoyed great privileges, and carried on an extensive commerce, particularly as bankers." (Robertson's History of Charles V.)

The English monarchs frequently borrowed money of the Lombards, as well as of other public bodies and of private individuals. The companies of foreign merchants made advances of money, which were repaid by the duties on their merchandise. The oldest and wealthiest of these companies, the Steel-Yard Company, was a kind of bank to the English kings, whenever they wanted money on any sudden emergency, but the company was sure to be well paid in the end for such assistance.

Interest Made Legal.—In the year 1546, the taking of interest for money was made legal in England,

and the rate was fixed at ten per cent. This Act was repealed in the year 1552, but it was re-enacted in 1571. The legal rate of interest was reduced to eight per cent in 1624, and to six per cent in 1651. In the year 1714 it was reduced to five per cent. After the taking of interest was sanctioned by law, the term usury, which was previously applied to interest in general, became limited, to denote a rate of interest higher than that which the law allowed.

Money-Borrowing.—That part of the business of banking which consists in the borrowing of money, with a view of lending it again at a higher rate of interest, does not appear to have been carried on by bankers until the year 1645, when a new era occurred in the history of banking. The goldsmiths, who were previously only money-changers, now became also money-lenders. They became also money borrowers, and allowed interest on the sums they borrowed. They were agents for receiving rents. They lent money to the king on the security of the taxes. The receipts they issued for the money lodged at their houses circulated from hand to hand, and were known by the name of "goldsmiths' notes." These may be considered as the first kind of bank notes issued in England. The following account of these banking goldsmiths as given by Gilbart, is taken chiefly from Anderson's "History of Commerce."

When the English merchants became enriched by commerce, they wished for a place of security in which they might deposit their wealth. Hence they usually sent their money to the mint in the Tower of London, which became a sort of bank. The merchants left their money there when they had no oc-

casion for it, and drew it out as they wanted it. But in 1640, King Charles I took possession of £200,000 of the merchants' money that had been lodged in the mint and from that period the merchants kept their money in their own houses, under the care of their servants and apprentices. On the breaking out of the civil war between Charles I and the parliament, it became very customary for the apprentices to rob their masters, and then run away and join the army. As the merchants could now place no confidence either in the public authorities or in their own servants, they were under the necessity of employing bankers.

The Banking Goldsmiths.—These bankers were the goldsmiths. Previous to this period, the business of the goldsmith was similar to what it is in our own time. They bought and sold plate and foreign coins; they procured gold to be coined at the mint, and supplied refiners, plate-makers, and others with the precious metals. To deal in gold and silver bullion to any large extent implies the possession of considerable wealth; and as all the money in the country then consisted of gold and silver coin, it was natural enough that the goldsmiths should become the bankers of those who had money for which they had no immediate use.

An account of the bankers of those days is related in a curious pamphlet, published in the year 1676, and entitled, "The Mystery of the New-fashioned Goldsmiths; or Bankers Discovered." The author says: "This new banking business soon grew very considerable. It happened in those times of civil commotion, that the Parliament, out of plates and

old coins brought into the mint, coined seven millions into half-crowns; and there being no mills then in use at the mint, this new money was of a very unequal weight, sometimes twopence and threepence difference in an ounce, and most of it was, it seems, heavier than it ought to have been in proportion to the value in foreign parts. Of this the goldsmiths made naturally the advantage usual in such cases, by picking out or culling the heaviest, and melting them down and exporting them.

"Moreover, such merchants' servants as still kept their masters' running cash, had fallen into a way of clandestinely lending the same to the goldsmiths at fourpence per cent per diem, who, by these and suchlike means, were enabled to lend out great quantities of cash to necessitous merchants and others, weekly or monthly, at high interest, and also began to discount the merchants' bills at the like or higher interest.

"Much about the same time, the goldsmiths (or new-fashioned bankers) began to receive the rents of gentlemen's estates remitted to town, and to allow them and others who put cash in their hands some interest for it, if it remained but a single month in their hands, or even a lesser time. This was a great allurement for people to put money into their hands, which would bear interest till the day they wanted it; and they could also draw it out by one hundred pounds or fifty pounds, etc., at a time as they wanted it, with infinitely less trouble than if they had lent it out on either real or personal security.

"The consequence was, that it quickly brought a great quantity of cash into their hands, so that the chief or greatest of them were now enabled to supply Cromwell with money in advance, on the revenues, as his occasion required, upon great advantages to themselves.

"After the Restoration, King Charles II being in want of money, the bankers took ten per cent of him barefacedly and by private contracts; on many bills, orders, tallies, and debts of that king, they got twenty, sometimes thirty per cent, to the great dishonor of the government.

"This great gain induced the goldsmiths more and more to become lenders to the king, to anticipate all the revenue, to take every grant of Parliament into pawn as soon as it was given; also to outvie each other in buying and taking to pawn bills, orders and tallies, so that in effect all the revenue passed through their hands."

Blamed for Money Scarcity.—The "new-fashioned bankers" were also attacked by Sir Josiah Child, in his "New Discourse of Trade," in the following terms:

"And principally this seeming scarcity of money proceeds from the trade of banking, which obstructs circulation, advanceth usury, and renders it so easy, that most men, as soon as they can make up a sum of from £50 to £100, send it in to the goldsmith, which doth and will occasion, while it lasts, that fatal pressing necessity for money visible throughout the whole kingdom, both to prince and people.

"A seventh accidental reason why land doth not sell at present at the rate it naturally should in proportion to the legal interest, is that innovated practice of bankers in London, which hath more effects attending it than most I have conversed with have yet observed; but I shall here take notice of that only which is to my present purpose, viz:—

"The gentlemen that are bankers, having a large interest from his Majesty for what they advance upon his Majesty's revenue, can afford to give the full legal interest to all persons that put money into their hands, though for never so short or long a time, which makes the trade of usury so easy and hitherto safe, that few, after having found the sweetness of this lazy way of improvement (being by continuance and success grown to fancy themselves secure in it), can be led (there being neither ease nor profit to invite them) to lay out their money in land, though at fifteen years' purchase; whereas before this way of private banking came up, men who had money were forced oftentimes to let it lie dead by them until they could meet with securities to their minds, and if the like necessity were now of money lying dead, the loss of use for the dead time being deducted from the profit of six per cent (communibus annis) would in effect take off £1 per cent per annum of the profit of usury, and consequently incline men more to purchase lands, because the difference between usury and purchasing would not, in point of profit, be so great as now it is, this new invention of cashiering having, in my opinion, clearly bettered the usurer's trade one or two per cent per annum. And that this way of leaving money with

goldsmiths hath had the aforesaid effect, seems evident to me from the scarcity it makes of money in the country; for the trade of bankers being only in London, doth very much drain the ready money from all other parts of the kingdom."

The First Run on a Bank.—In the year 1667 occurred the first "run" of which we have any account in the history of banking. The business of the new-fashioned bankers had increased so fast, and they had become so numerous, that their trade was supposed to be at its height in this year; when, during the time that a treaty of peace was under consideration, the Dutch fleet sailed up the Thames, blew up the fort of Sheerness, set fire to Chatham, and burned four ships of the line. This disaster occasioned great alarm in London, particularly among those who had money in their bankers' hands, as it was imagined that the king would not be able to repay the bankers the money they had lent him. To quiet the fears of the people, the king issued a proclamation, declaring that the payments to the bankers should be made at the Exchequer the same as usual.

In 1672, five years afterwards, a much greater calamity befell the bankers; for King Charles II shut up the Exchequer, and would not pay the bankers either the principal or the interest of the money which he had borrowed. The amount then due by the king was £1,328,526, which he had borrowed of the bankers at eight per cent, and which he never repaid.

The mode in which the bankers transacted their

loans with the king was this: As soon as the parliament had voted to the king certain sums of money out of particular taxes, the bankers advanced at once the money voted by parliament, and were repaid in weekly payments at the Exchequer as the taxes were received. The mode of making the payments and the rate of interest were agreed upon at the time of making the loan.

The shutting up of the Exchequer occasioned great distress among all classes of people. Persons not in trade had then no way of employing their money with advantage but by placing it out at interest in the hands of a banker. Hence, not merchants only, but widows, orphans, and others, became suddenly deprived of the whole of their property. They came in crowds to the bankers, but could obtain neither the principal nor the interest on the money they had deposited. The clamor became so great that the king granted a patent to pay six per cent interest out of his hereditary excise; but he never paid the principal. But, about forty years afterward, the parliament made arrangements by which the debt was assumed to be discharged; that is, it became a part of the National Debt, but the creditors received nothing.

The business of banking remained entirely in the hands of the "new-fashioned" bankers until the establishment of the Bank of England, in the year 1694.

Transmission of Money.—The transmission of money was in ancient times effected by sending a messenger with the coin. During the Middle Ages,

it was accomplished by means of bills of exchange, which were purchased by merchants. Ultimately, a special class of persons carried on this kind of traffic, and purchased or sold bills to suit the convenience of parties who wished to deal with them. The pecuniary transactions of independent nations are still adjusted in the same way. But the transmission of money from one part of the country to another part, is more frequently effected upon the principle of transfers, without the passing of any bills. This branch of banking is fully dealt with elsewhere in this volume.

The Bank of England.—Previous to the year 1694 there were only four banks of any great consequence in Europe, but on the 27th of July of that year a charter was granted by the reigning sovereigns, William and Mary, for establishing the Bank of England, which for opulence, importance, and extent of circulation became the greatest in the world.

The object of the promoters was to raise money for the use of the government. When the scheme was brought before the parliament, it caused a long and violent discussion. One party dwelt upon the national advantages that would accrue from such a measure. They said it would rescue the nation out of the hands of extortioners and usurers, lower the rates of interest, raise the value of land, revive and establish public credit, extend the circulation, and consequently improve commerce, facilitate the annual supplies for the national expenses, and connect the people more closely with the government.

The opposition party declared that such a bank

would become a monopoly and engross the whole money of the kingdom; that it must infallibly become subservient to government views, and might be employed for the worst purposes of arbitrary power; that instead of assisting, it would weaken commerce, by tempting people to withdraw their money from trade and employ it in stock-jobbing; that it would produce a swarm of brokers and jobbers to prey upon their fellow-creatures, encourage fraud and gambling, and thus corrupt the morals of the nation.

Notwithstanding these objections, the Act passed both houses of parliament, and received the royal assent.

Opposition of Foreign Competitors.—It was noticed that foreign competitors for English trade strongly opposed the project, and not long after the bank had been established, Bishop Burnet wrote: "The advantages the king and all concerned in tallies had from the bank were soon so sensibly felt that all people saw into the secret reasons that made the enemies of the constitution set themselves with so much earnestness against it."

In the English Exchequer, the "tallies" referred to by Bishop Burnet were long used in lieu of certificates of indebtedness to creditors of the state. These tallies were seasoned sticks of willow or hazel, notched on the edge to represent the amount. Small notches represented pence; larger notches shillings, and still larger, pounds. Proportionately larger and wider notches represent £10, £100 or £1000 pounds. The stick being then split longitudinally, one piece

was given to the creditor and the other was laid away as a record. When an account was presented for payment, the voucher was compared with the record. When paid, the tally and counter-tally were tied up together and laid away, accumulating for a long series of years. This system was in use until 1812. The tallies were received as evidence in courts of justice.

The Act of Parliament.—The act of Parliament by which the Bank of England was established was entitled, "An Act for granting to their Majesties several duties upon tonnage of ships and vessels, and upon beer, ale, and other liquors, for securing certain recompenses and advantages in the said Act mentioned, to such persons as shall voluntarily advance the sum of fifteen hundred thousand pounds towards carrying on the war with France." After a veriety of enactments relative to the "duties upon tonnage of ships and vessels, and upon beer, ale, and other liquors," the Act authorizes the raising of £1,200,000 ($6,000,000) by voluntary subscription, the subscribers to be formed into a corporation, and be styled "The Governor and Company of the Bank of England." The sum of £300,000 was also to be raised by subscription, and the contributors to receive instead annuities for one, two, or three lives. Towards the £1,200,000 no one person was to subscribe more than £10,000 before the first day of July next ensuing, nor at any time more than £20,000. The corporation were to lend their whole capital to government, for which they were to receive interest at the rate of eight per cent per annum, and £4,000 per annum for management; being £100,000 per

annum in the whole. The corporation were not allowed to borrow or owe more than the amount of their capital, and if they did so the individual members became liable to the creditors in proportion to the amount of their stock. The corporation were not to trade in any "goods, wares, or merchandise whatsoever;" but they were allowed to deal in bills of exchange, gold or silver bullion, and to sell any goods, wares, or merchandise upon which they had advanced money, and which had not been redeemed within three months after the time agreed upon.

Provisions of the Charter.—The whole subscription having been filled in ten days, a charter was issued on the 27th day of July, 1694. The charter declares:

"That the management and government of the corporation be committed to the governor, deputy-governor, and twenty-four directors, who shall be elected between the 25th day of March and the 25th day of April each year, from among the members of the company duly qualified.

"That no dividend shall at any time be made by the said governor and company, save only out of the interest, profit, or produce arising out of the said capital, stock, or fund, or by such dealing as is allowed by Act of Parliament.

"They must be natural-born subjects of England, or naturalized subjects; they shall have in their own name and for their own use, severally, viz., the governor at least £4,000 the deputy-governor £3,000, and each director £2,000, of the capital stock of the said corporation.

"That thirteen or more of the said governors or directors (of which the governor or deputy-governor shall be always one), shall constitute a court of directors for the management of the affairs of the company, and for the appointment of all agents and servants which may be necessary, paying them salaries as they may consider reasonable.

"Every elector must have, in his own name and for his own use, £500 or more, capital stock, and can only give one vote; he must, if required by any member present, take the oath of stock, or the declaration of stock if it be one of those people called Quakers.

"Four general courts to be held in every year, in the months of September, December, April, and July. A general court may be summoned at any time, upon the requisition of nine proprietors duly qualified as electors.

"The majority of electors in general courts have the power to make and constitute by-laws and ordinances for the government of the corporation, provided that such by-laws and ordinances be not repugnant to the laws of the kingdom, and be conformed and approved, according to the statutes in such case made and provided."

The above charter, which was originally granted for ten years only, has been subject to many renewals. The capital of the bank has been vastly increased and its operations have been governed by numerous acts of parliament. It enjoys a wonderful record for wise and conservative management, and is an institution of which the entire British Empire is justly proud.

Agents for the Government.—In 1718, subscriptions for government loans were first received at the bank, and from this period the British government has found it more convenient to employ the bank as its agents in all operations of this nature, than to transact them at the Treasury or the Exchequer. The bank became by degrees more closely connected with the government, and soon began to make advances of money in anticipation of the taxes, and upon Exchequer bills and other securities, by the establishment of what is now called bank circulation; that is by the issuance of secured notes.

By 1722, the bank capital had increased by new subscriptions to a total of approximately £9,000,000 or nearly $45,000,000. In 1734, June 5th, the directors began to transact business in their new house in Threadneedle Street, in the heart of the city of London. The business of the bank had previously been carried on at Grocers' Hall, in the Poultry. From that day until the period of the World War (1914-1918) "the Old Lady of Threadneedle Street" led the financial institutions of the world.

In 1737 there was considerable public discussion about the propriety of again renewing the bank charter. In the course of the public debate, the following opinion of the bank operations was expressed in the London Magazine:

"There certainly never was a body of men that contributed more to the public safety than the Bank of England. This flourishing and opulent company have, upon every emergency, always cheerfully and readily supplied the necessities of the nation, so that

there never have been any difficulties—any embarrassment—any delays in raising the money which has been granted by parliament for the service of the public; and it may very truly be said that they have, in very many important conjunctures, relieved the nation out of the greatest difficulties, if not absolutely saved it from ruin."

Events in the Bank's History.—In 1745, there was a run upon the bank, occasioned by the rebellion in Scotland, and supposed to be for the purpose of supplying the adherents of the Stuarts with gold. A public meeting was held in London and one thousand one hundred and forty merchants signed a declaration expressing their readiness to take the bank notes.

The 3 per cent Consols were established by means of the bank in 1752 and have ever since been a famous government stock. The word "consols" is a contraction for "consolidated." Outstanding government annuities were consolidated in the 3 per cents.

In 1758 occurred the first instance of a forgery of a bank note. The note was for £20, the smallest amount then in circulation. The forger was promptly convicted and executed.

In 1782, the total capital of the bank was increased to £11,642,400, or approximately $58,000,000. There was no further increase of capital until the year 1816, since which time it has been largely increased.

In 1794, the bank commenced issuing its famous £5 notes.

During various periods of financial depression, the government of England has rendered assistance to the bank by timely administrative action, enabling it to maintain its high reputation and meet all its obligations; and the bank on its side has made many advances to the government, besides managing the public debt and otherwise aiding in the operation of the government finances. It enjoys certain exclusive privileges of banking in England, and fixes the bank rate of discount at regular meetings of "courts" of its board of governors, which are referred to elsewhere in connection with the subject of Foreign Exchange.

The Bank of England building covers a whole block bounded on the south by Threadneedle Street. Outside it presents the appearance of a blind outer wall of a great building without windows, and having here and there ornamental pillars and few entrances. The plan is a complex system of offices, court yards, etc., the result of growth and necessity.

Among the curiosities in the bank library is a million pound bank note. Tradition says that there have been only four such notes issued.

Another curiosity in the bank library is a note for £25, which had slumbered unobserved for 111 years, and was then presented and paid. If compound interest had been payable by the bank, the owner could have claimed over £60,000.

About 50,000 notes of different values are paid into the bank every day. These are kept five

years in the bank cellars and are then destroyed by burning. New notes are always given out in payment of bills and checks.

Questions for Review, Appendix

"HISTORY OF BANKING"

1. What is the earliest evidence that ancient money changers allowed interest on funds lodged in their hands?

2. What form of banks existed in ancient Greece?

3. What methods were employed by the Athenian bankers?

4. Where do we find the first historic suggestion for the establishment of a joint-stock bank?

5. What were the bankers and banking houses of ancient Rome called?

6. How were the Roman bankers connected with the state?

7. What is the popular origin of the word "bank"?

8. What other derivation of the word bank has received support?

9. How did the Florentine bankers of Italy achieve their reputation?

10. Where was the first national bank founded in Europe, and when?

11. What were the characteristics of the Bank of Venice?

12. When were the first bills of exchange employed in commerce?

13. When was the Bank of Amsterdam established and to what cause is its origin ascribed?

14. What is the meaning of the term "agio"?

15. What was the general rate of the "agio" of Amsterdam?

16. How was the Bank of Amsterdam managed?

17. When was the Bank of North America established, and on what plan?

18. State briefly the history of the first Bank of the United States.

20. What was the object of the Monetary Commission appointed by the United States Senate in 1910, and its outcome?

21. When was gold first coined in England, and when did it enter permanently into currency?

22. What was the function of the office of Royal Exchanger?

23. Why was this office re-established by Charles I?

24. When did the business of money-changing fall into the hands of the goldsmiths of London?

25. Why was the business of money-lending conducted during the Middle Ages under severe restraints?

26. When do we find the earliest mention in English history of a market rate of interest?

27. Who were the principal money-lenders in England during the evolution of banking?

28. Who were the Lombards, and what was their connection with English banking?

29. When was the taking of interest for money made legal in England, and at what rate?

30. When did the borrowing of money by bankers for loaning purposes originate?

31. What was the nature of the "goldsmith's notes," the first kind of notes issued in England?

32. How long did the business of banking remain entirely in the hands of the so-called "new-fashioned" bankers?

33. How was the transmission of money effected during the Middle Ages?

34. When was the Bank of England established?

35. What objections were raised to its establishment?

36. How is the Bank of England governed?

37. How is the English bank rate of discount fixed?

38. What is the relation of the Bank of England to the British government?

PROVISIONS OF THE EDGE BILL

Banking Corporations Authorized to do Foreign Banking Business.

The Edge bill, providing for the Federal incorporation of institutions organized for the purpose of carrying on international or foreign banking and other financial operations, was approved by the President December 24, 1919. The text of the law is given below:

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the act approved December 23, 1913, known as the Federal Reserve Act, as amended, be further amended by adding a new section as follows:

"Sec. 25 (a). Corporations to be organized for the purpose of engaging in international or foreign banking or other international or foreign financial operations, or in banking or other financial operations in a dependency or insular possession of the United States, either directly or through the agency, ownership, or control of local institutions in foreign countries, or in such dependencies or insular possessions as provided by this section, and to act when required by the Secretary of the Treasury as fiscal agents of the United States, may be formed by any number of natural persons, not less in any case than five.

"Such persons shall enter into articles of association which shall specify in general terms the objects for which the association is formed and may contain any other provisions not inconsistent with law which the association may see fit to adopt for the regulation of its business and the conduct of its affairs.

"Such articles of association shall be signed by all of the persons intending to participate in the organization of the corporation, and thereafter shall be forwarded to the Federal Reserve Board and shall be filed and preserved in its office. The persons signing the said articles of association shall, under their hands, make an organization certificate which shall specifically state:

"First. The name assumed by such corporation, which shall be subject to the approval of the Federal Reserve Board.

"Second. The place or places where its operations are to be carried on.

"Third. The place in the United States where its home office is to be located.

"Fourth. The amount of its capital stock and the number of shares into which the same shall be divided.

"Fifth. The names and places of business or residence of the persons executing the certificate and the number of shares to which each has subscribed.

"Sixth. The fact that the certificate is made to enable the persons subscribing the same, and all other persons, firms, companies, and corporations, who or which may thereafter subscribe to or purchase shares of the capital stock of such corporation,

to avail themselves of the advantages of this section.

"The persons signing the organization certificate shall duly acknowledge the execution thereof before a judge of some court of record or notary public, who shall certify thereto under the seal of such court or notary, and thereafter the certificate shall be forwarded to the Federal Reserve Board to be filed and preserved in its office. Upon duly making and filing articles of association and an organization certificate, and after the Federal Reserve Board has approved the same and issued a permit to begin business, the association shall become and be a body corporate, and as such and in the name designated therein shall have power to adopt and use a corporate seal, which may be changed at the pleasure of its board of directors; to have succession for a period of twenty years unless sooner dissolved by the act of the shareholders owning two-thirds of the stock or by an act of Congress or unless its franchise becomes forfeited by some violation of law; to make contracts; to sue and be sued, complain, and defend in any court of law or equity; to elect or appoint directors, all of whom shall be citizens of the United States; and, by its board of directors, to appoint such officers and employees as may be deemed proper, define their authority and duties, require bonds of them, and fix the penalty thereof, dismiss such officers or employees, or any thereof, at pleasure and appoint others to fill their places; to prescribe, by its board of directors, by-laws not inconsistent with law or with the regulations of the Federal Reserve Board regulating the manner in which its stock shall be

transferred, its directors elected or appointed, its officers and employees appointed, its property transferred, and the privileges granted to it by law exercised and enjoyed.

Powers Conferred on Corporations Organized.

"Each corporation so organized shall have power, under such rules and regulations as the Federal Reserve Board may prescribe:

"(a) To purchase, sell, discount, and negotiate, with or without its indorsement or guaranty, notes, drafts, checks, bills of exchange, acceptances, including bankers' acceptances, cable transfers, and other evidences of indebtedness; to purchase and sell, with or without its indorsement or guaranty, securities, including the obligations of the United States or of any State thereof but not including shares of stock in any corporation except as herein provided; to accept bills or drafts drawn upon it subject to such limitations and restrictions as the Federal Reserve Board may impose; to issue letters of credit; to purchase and sell coin, bullion, and promissory notes under such general conditions as to security and such limitations as the Federal Reserve Board may prescribe, but in no event having liabilities outstanding thereon at any one time exceeding ten times its capital stock and surplus; to receive deposits outside of the United States and to receive only such deposits within the United States as may be incidental to or for the purpose of carrying out transactions in foreign countries or dependencies or insular possessions of the United States; and generally to exercise such powers as are incidental to the powers conferred by this act or as may be usual, in the determination of

the Federal Reserve Board, in connection with the transaction of the business of banking or other financial operations in the countries, colonies, dependencies, or possessions in which it shall transact business and not inconsistent with the powers specifically granted herein. Nothing contained in this section shall be construed to prohibit the Federal Reserve Board, under its power to prescribe rules and regulations, from limiting the aggregate amount of liabilities of any or all classes incurred by the corporation and outstanding at any one time. Whenever a corporation organized under this section receives deposits in the United States authorized by this section it shall carry reserves in such amounts as the Federal Reserve Board may prescribe, but in no event less than 10 per centum of its deposits.

"(b) To establish and maintain for the transaction of its business branches or agencies in foreign countries, their dependencies or colonies, and in the dependencies or insular possessions of the United States, at such places as may be approved by the Federal Reserve Board and under such rules and regulations as it may prescribe, including countries or dependencies not specified in the original organization certificate.

"(c) With the consent of the Federal Reserve Board to purchase and hold stock or other certificates of ownership in any other corporation organized under the provisions of this section or under the laws of any State, dependency, or insular possession of the United States but not engaged in the general business of buying or selling goods, wares, merchandise, or commodities in the United States, and not

transacting any business in the United States except such as in the judgment of the Federal Reserve Board may be incidental to its international or foreign business: Provided, however, That, except with the approval of the Federal Reserve Board, no corporation organized hereunder shall invest in any one corporation an amount in excess of 10 per centum of its own capital and surplus, except in a corporation engaged in the business of banking, when 15 per centum of its capital and surplus may be so invested: Provided further, That no corporation organized hereunder shall purchase, own, or hold stock or certificates of ownership in any other corporation organized hereunder or under the laws of any State which is in substantial competition therewith, or which holds stock or certificates of ownership in corporations which are in substantial competition with the purchasing corporation.

"Nothing contained herein shall prevent corporations organized hereunder from purchasing and holding stock in any corporation where such purchase shall be necessary to prevent a loss upon a debt previously contracted in good faith; and stock so purchased or acquired in corporations organized under this section shall within six months from such purchase be sold or disposed of at public or private sale unless the time to so dispose of same is extended by the Federal Reserve Board.

"No corporation organized under this section shall carry on any part of its business in the United States except such as, in the judgment of the Federal Reserve Board, shall be incidental to its international or foreign business: And provided further, That

except such as is incidental and preliminary to its organization no such corporation shall exercise any of the powers conferred by this section until it has been duly authorized by the Federal Reserve Board to commence business as a corporation organized under the provisions of this section.

"No corporation organized under this section shall engage in commerce or trade in commodities except as specifically provided in this section, nor shall it either directly or indirectly control or fix or attempt to control or fix the price of any such commodities. The charter of any corporation violating this provision shall be subject to forfeiture in the manner hereinafter provided in this section. It shall be unlawful for any director, officer, agent, or employee of any such corporation to use or to conspire to use the credit, the funds, or the power of the corporation to fix or control the price of any such commodities, and any such person violating this provision shall be liable to a fine of not less than $1,000 and not exceeding $5,000 or imprisonment not less than one year and not exceeding five years, or both, in the discretion of the court.

Minimum Amount of Capital Stock Provided.

"No corporation shall be organized under the provisions of this section with a capital stock of less than $2,000,000, one-quarter of which must be paid in before the corporation may be authorized to begin business, and the remainder of the capital stock of such corporation shall be paid in installments of at least 10 per centum on the whole amount to which the corporation shall be limited as frequently as one installment at the end of each succeeding two months

from the time of the commencement of its business operations until the whole of the capital stock shall be paid in. The capital stock of any such corporation may be increased at any time, with the approval of the Federal Reserve Board, by a vote of two-thirds of its shareholders or by unanimous consent in writing of the shareholders without a meeting and without a formal vote, but any such increase of capital shall be fully paid in within ninety days after such approval, and may be reduced in like manner, provided that in no event shall it be less than $2,000,000. No corporation, except as herein provided, shall during the time it shall continue its operations withdraw or permit to be withdrawn, either in the form of dividends or otherwise, any portion of its capital. Any national banking association may invest in the stock of any corporation organized under the provisions of this section, but the aggregate amount of stock held in all corporations engaged in business of the kind described in this section and in section 25 of the Federal reserve act as amended shall not exceed 10 per centum of the subscribing bank's capital and surplus.

"A majority of the shares of the capital stock of any such corporation shall at all times be held and owned by citizens of the United States, by corporations the controlling interest in which is owned by citizens of the United States, chartered under the laws of the United States or of a State of the United States, or by firms or companies, the controlling interest in which is owned by citizens of the United States. The provisions of section 8 of the act approved October 15, 1914, entitled 'An act to supple-

ment existing laws against unlawful restraints and monopolies, and for other purposes,' as amended by the acts of May 15, 1916, and September 7, 1916, shall be construed to apply to the directors, other officers, agents, or employees of corporations organized under the provisions of this section: Provided, however, That nothing herein contained shall (1) prohibit any director or other officer, agent, or employee of any member bank, who has procured the approval of the Federal Reserve Board from serving at the same time as a director or other officer, agent, or employee of any corporation organized under the provisions of this section in whose capital stock such member bank shall have invested; or (2) prohibit any director or other officer, agent, or employee of any corporation organized under the provisions of this section, who has procured the approval of the Federal Reserve Board, from serving at the same time as a director or other officer, agent, or employee of any other corporation in whose capital stock such first-mentioned corporation shall have invested under the provisions of this section.

"No member of the Federal Reserve Board shall be an officer or director of any corporation organized under the provisions of this section, or on any corporation engaged in similar business organized under the laws of any State, nor hold stock in any such corporation, and before entering upon his duties as a member of the Federal Reserve Board he shall certify under oath to the Secretary of the Treasury that he has complied with this requirement.

"Shareholders in any corporation organized under the provisions of this section shall be liable for the

amount of their unpaid stock subscriptions. No such corporation shall become a member of any Federal reserve bank.

Privileges Forfeited for Failure to Comply with Provisions—Liquidation.

"Should any corporation organized hereunder violate or fail to comply with any of the provisions of this section, all of its rights, privileges, and franchises derived herefrom may thereby be forfeited. Before any such corporation shall be declared dissolved, or its rights, privileges, and franchises forfeited, any noncompliance with, or violation of such laws shall, however, be determined and adjudged by the United States of competent jurisdiction, in a suit brought for that purpose in the district or territory in which the home office of such corporation is located, which suit shall be brought by the United States at the instance of the Federal Reserve Board or the Attorney General. Upon adjudication of such noncompliance or violation, each director and officer who participated in, or assented to, the illegal act or acts, shall be liable in his personal or individual capacity for all damages which the said corporation shall have sustained in consequence thereof. No dissolution shall take away or impair any remedy against the corporation, its stockholders, or officers for any liability or penalty previously incurred.

"Any such corporation may go into voluntary liquidation and be closed by a vote of its shareholders owning two-thirds of its stock.

"Whenever the Federal Reserve Board shall become satisfied of the insolvency of any such corpora-

tion, it may appoint a receiver who shall take possession of all of the property and assets of the corporation and exercise the same rights, privileges, powers, and authority with respect thereto as are now exercised by receivers of national banks appointed by the Comptroller of the Currency of the United States: Provided, however, That the assets of the corporation subject to the laws of other countries or jurisdictions shall be dealt with in accordance with the terms of such laws.

"Every corporation organized under the provisions of this section shall hold a meeting of its stockholders annually upon a date fixed in its by-laws, such meeting to be held at its home office in the United States. Every such corporation shall keep at its home office books containing the names of all stockholders thereof, and the names and addresses of the members of its board of directors, together with copies of all reports made by it to the Federal Reserve Board. Every such corporation shall make reports to the Federal Reserve Board at such times and in such form as it may require; and shall be subject to examination once a year and at such other times as may be deemed necessary by the Federal Reserve Board by examiners appointed by the Federal Reserve Board, the cost of such examinations, including the compensation of the examiners, to be fixed by the Federal Reserve Board and to be paid by the corporation examined.

"The directors of any corporation organized under the provisions of this section may, semiannually, declare a dividend of so much of the net profits of the corporation as they shall judge expedient; but each

corporation shall, before the declaration of a dividend, carry one-tenth of its net profits of the preceding half year to its surplus fund until the same shall amount to 20 per centum of its capital stock.

"Any corporation organized under the provisions of this section shall be subject to tax by the State within which its home office is located in the same manner and to the same extent as other corporations organized under the laws of that State which are transacting a similar character of business. The shares of stock in such corporation shall also be subject to tax as the personal property of the owners or holders thereof in the same manner and to the same extent as the shares of stock in similar State corporations.

"Any corporation organized under the provisions of this section may at any time within the two years next previous to the date of the expiration of its corporate existence, by a vote of the shareholders owning two-thirds of its stock, apply to the Federal Reserve Board for its approval to extend the period of its corporate existence for a term of not more than twenty years, and upon certified approval of the Federal Reserve Board such corporation shall have its corporate existence for such extended period unless sooner dissolved by the act of the shareholders owning two-thirds of its stock, or by an act of Congress, or unless its franchise becomes forfeited by some violation of law.

Banking Institutions May Be Converted.

"Any bank or banking institution, principally engaged in foreign business, incorporated by special

law of any State or of the United States or organized under the general laws of any State or of the United States and having an unimpaired capital sufficient to entitle it to become a corporation under the provisions of this section may, by the vote of the shareholders owning not less than two-thirds of the capital stock of such bank or banking association, with the approval of the Federal Reserve Board, be converted into a Federal corporation of the kind authorized by this section with any name approved by the Federal Reserve Board: Provided, however, That said conversion shall not be in contravention of the State law. In such case the articles of association and organization certificate may be executed by a majority of the directors of the bank or banking institution, and the certificate shall declare that the owners of at least two-thirds of the capital stock have authorized the directors to make such certificate and to change or convert the bank or banking institution into a Federal corporation. A majority of the directors, after executing the articles of association and the organization certificate, shall have power to execute all other papers and to do whatever may be required to make its organization perfect and complete as a Federal corporation. The shares of any such corporation may continue to be for the same amount each as they were before the conversion, and the directors may continue to be directors of the corporation until others are elected or appointed in accordance with the provisions of this section. When the Federal Reserve Board has given to such corporation a certificate that the provisions of this section have been complied with, such corporation and all its stockholders, officers, and

employees shall have the same powers and privileges, and shall be subject to the same duties, liabilities, and regulations, in all respects, as shall have been prescribed by this section for corporations originally organized hereunder.

"Every officer, director, clerk, employee, or agent of any corporation organized under this section who embezzles, abstracts, or willfully misapplies any of the moneys, funds, credits, securities, evidences of indebtedness or assets of any character of such corporation; or who, without authority from the directors, issues or puts forth any certificate of deposit, draws any order or bill of exchange, makes any acceptance, assigns any note, bond, debenture, draft, bill of exchange, mortgage, judgment, or decree; or who makes any false entry in any book, report, or statement of such corporation with intent, in either case, to injure or defraud such corporation or any other company, body politic or corporate, or any individual person, or to deceive any officer of such corporation, the Federal Reserve Board, or any agent or examiner appointed to examine the affairs of any such corporation; and every receiver of any such corporation and every clerk or employee of such receiver who shall embezzle, abstract, or willfully misapply or wrongfully convert to his own use any moneys, funds, credits, or assets of any character which may come into his possession or under his control in the execution of his trust or the performance of the duties of his employment; and every such receiver or clerk or employee of such receiver who shall, with intent to injure or defraud any person, body politic or corporate, or to deceive or mis-

lead the Federal Reserve Board, or any agent or examiner appointed to examine the affairs of such receiver, shall make any false entry in any book, report, or record of any matter connected with the duties of such receiver; and every person who with like intent aids or abets any officer, director, clerk, employee, or agent of any corporation organized under this section, or receiver or clerk or employee of such receiver as aforesaid in any violation of this section, shall upon conviction thereof be imprisoned for not less than two years nor more than ten years, and may also be fined not more than $5,000, in the discretion of the court.

"Whoever being connected in any capacity with any corporation organized under this section represents in any way that the United States is liable for the payment of any bond or other obligation, or the interest thereon, issued or incurred by any corporation organized hereunder, or that the United States incurs any liability in respect of any act or omission of the corporation, shall be punished by a fine of not more than $10,000 and by imprisonment for not more than five years."

State and National Banks, 1920.

On February 28, 1920, there were 21,961 State banking institutions with a total capital of $1,402,-365,014.88; with deposits of $24,189,608,399.21; and total resources of $29,024,095,838.83.

At the same date the Comptroller of the Currency in his report lists 7,933 National banks with total deposits of $16,965,122,000; and total resources of

$21,862,540,000. The number of State banks in the country exceeded the number of National banks by 14,028. The deposits in the State banks exceeded the deposits of the National banks by $7,224,486,-399.21.

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